H.R. 3185, THE 401(K) FAIR DISCLOSURE FOR RETIREMENT SECURITY ACT OF 2007

HEARING

BEFORE THE

COMMITTEE ON EDUCATION AND LABOR

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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C O N T E N T S

H.R. 3185, THE 401(k) FAIR DISCLOSURE FOR RETIREMENT SECURITY ACT OF 2007

Thursday, October 4, 2007
U.S. House of Representatives
Committee on Education and Labor
Washington, DC

The committee met, pursuant to call, at 10:35 a.m., in room 2175, Rayburn House Office Building, Hon. George Miller [chairman of the committee] presiding.

Present: Representatives Miller, Andrews, McCarthy, Kuchinich, Holt, Grijalva, Bishop of New York, Sestak, Loebsack, Hare, Clarke, Courtney, Shea-Porter, McKeon, Petri, Castle, Ehlers, Platts, Kline, Marchant, Boustany, Foxx, and Davis of Tennessee.

Staff present: Aaron Albright, Press Secretary; Tylease Alli, Hearing Clerk; Chris Brown, Labor Policy Advisor; Lynn Dondis, Policy Advisor for Subcommittee on Workforce Protections; Carlos Fenwick, Policy Advisor for Subcommittee on Health, Employment, Labor and Pensions; Michael Gaffin, Staff Assistant, Labor; Jeffrey Hancuff, Staff Assistant, Labor; Danielle Lee, Press/Outreach Assistant; Rachel Racusen, Deputy Communications Director; Michele Varnhagen, Labor Policy Director; Robert Borden, Minority General Counsel; Cameron Coursen, Minority Assistant Communications Director; Rob Gregg, Minority Legislative Assistant; Victor Klatt, Minority Staff Director; Alexa Marrero, Minority Communications Director; Jim Paretti, Minority Workforce Policy Counsel; Molly McLaughlin Salmi, Minority Deputy Director of Workforce Policy; Ken Serafin, Minority Professional Staff Member; and Linda Stevens, Minority Chief Clerk/Assistant to the General Counsel.

Chairman MILLER [presiding]. The Committee on Education and Labor will come to order to receive testimony on H.R. 3185, the 401(K) Fair Disclosure for Retirement Security Act.

Over the last 3 decades, the number of Americans with 401(k)-style retirement savings plans has skyrocketed, while the number of Americans with traditional plans has plummeted. Today, 50 million workers have 401(k)-style plans. These plans were originally intended to help supplement workers' retirement income, not to become the main source of their retirement income. Yet nearly two-thirds of private sector workers who have pensions have a 401(k) plans, and only a 401(k) plan.

The median 401(k) account balance is now $19,000. For many retirees, that is not enough to finance a single year of retirement. It

is no surprise that many Americans worry about how they will ever have enough savings to last them throughout retirement.

Given the increasingly prominent role of 401(k) plans, it is critical that the plans provide the best possible deals for their participants. Unfortunately, far too many 401(k) plan participants are not getting the best deals possible. Many 401(k)-style plans charge hidden fees that can cut deeply into workers' retirement savings. And many plan participants do not have access to low-cost investment options, such as an index fund, that can help them boost their retirement savings.

At a committee hearing earlier this year, the General Accountability Office testified about the problems posed by hidden 401(k) fees. Under current law, weak disclosure requirements mean that workers lack critical information about fees they are paying. According to the GAO's testimony, 80 percent of workers did not know that fees were being taken out of their accounts. Without this information, workers simply cannot shop around for the best arrangements for their retirement.

Some of these fees may be reasonable and necessary, but earlier this year we heard testimony about a dizzying array of fees: revenue sharing fees, wrap fees, finders fees, shelf space fees, surrender fees, and 12(b)(1) fees. I am sure many workers, if they knew about these fees, would not be willing to pay them or would look for lower fees in those same categories. The negative consequences of these hidden fees can be significant. According to GAO, a 1 percentage point increase in fees would cut retirement income by almost 20 percent after 20 years and 30 percent over 30 years.

The 401(k) Fair Disclosure Retirement Security Act would require 401(k) plans to disclose in clear and simple terms all the fees that they are charging to plan participants. The legislation would require that 401(k) plans provide workers with key information on investment options and their risk, returns and fees. The legislation would also require employers to offer at least one low-cost index fund as an investment option for employees participating in 401(k) plans.

Studies have shown that index funds outperform an overwhelming majority of actively managed, often higher-cost funds. Plan participants don't have to choose to invest in the index fund if they don't want to, but they should be able to make that choice for themselves.

Finally, the legislation will assist employers by requiring that plan officials know the fees that will be charged before they contract for investment services and disclose any potential conflicts of interest they may have.

After a lifetime of hard work, retirees ought to have the financial security that allows them to focus on family and friends without sacrificing their standard of living. Helping workers to make better-informed decisions about their retirement options is a critical step toward increasing retirement security for America's workers.

I would like to thank all of our witnesses today who are joining us. I look forward to their testimony and to hearing their thoughts on how we can move forward with this important piece of legislation.

I would like now to recognize the senior Republican on our committee, Mr. Buck McKeon, from California.

[The statement of Mr. Miller follows:]

Prepared Statement of Hon. George Miller, Chairman, Committee on Education and Labor

Today the committee will hear testimony on H.R. 3185, the "401(k) Fair Disclosure for Retirement Security Act."

Over the last three decades, the number of Americans with 401(k)-style retirement savings plans has skyrocketed, while the number of Americans with traditional pension plans has plummeted. Today, 50 million workers have 401(k)-style plans.

These plans were originally intended to help supplement workers' retirement income, not to become the main source of their retirement income. Yet nearly two-thirds of private sector workers (*http://www.ebri.org/pdf/publications/facts/0607fact.pdf*) who have a pension have a 401(k)—and only a 401(k).

The median 401(k) account balance is now $19,000. For many retirees, that's not even enough to finance a single year of retirement. It's no surprise that many Americans worry about how they will ever have enough savings to last them throughout retirement.

Given the increasingly prominent role of 401(k) plans, it is critical that the plans provide the best possible deals for their participants.

Unfortunately, far too many 401(k) plan participants are not getting the best deals possible. Many 401(k)-style plans charge hidden fees that can cut deeply into workers' retirement savings. And many plan participants do not have access to low-cost investment options—index funds—that can help them boost their retirement savings.

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According to the GAO's testimony, 80 percent of workers did not know that fees were being taken out of their accounts. Without this information, workers simply cannot shop around for the best deals for their retirement.

Some of these fees may be reasonable and necessary. But earlier this year, we heard testimony about a dizzying array of fees: "Revenue sharing fees." "Wrap fees." "Finders' fees." "Shelf space fees." "Surrender charges." "12(b)(1) fees."

I'm sure that many workers, if they knew about these fees, would not be willing to pay them.

The negative consequences of these hidden fees can be significant. According to GAO, a 1 percentage point increase in fees would cut retirement income by almost 20 percent after 20 years and 30 percent over 30 years.

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After a lifetime of hard work, retirees ought to have financial security that allows them to focus on family and friends without sacrificing their standard of living.

Helping workers to make better-informed decisions about their retirement options is a critical step towards increasing retirement security for America's workers.

I would like to thank all of our witnesses for joining us today. I look forward to their testimony and to hearing their thoughts on how to move forward with this important legislation.

Thank you.

Mr. MCKEON. Thank you, Chairman Miller, for convening this hearing. As you know, this committee has been at the forefront when it comes to ensuring retirement security. I am pleased that you are continuing to focus on this critical issue.

The pension reform laws enacted last year were the most sweeping in a generation. I am proud that those reforms originated in this committee. As those changes take hold, I believe they will make a real difference to workers, retirees and employers alike.

We are here today to examine your bill, Mr. Chairman, to significantly increase disclosure requirements. Let me say first that I appreciate the opportunity to thoroughly review the legislation. I think legislative hearings are a critical tool for lawmakers. These hearings allow us to ask important questions of those who would be impacted. They also allow us to explore the potential consequences of a proposal, both intended and unintended.

On the issue of disclosure, let me be clear. I am strongly supportive of providing meaningful, practical information to retirement plan participants. However, I cannot support massive new disclosure requirements without a clearly identified need for such requirements, which I fear do more harm than good. Surely, that must be our first imperative, to do no harm.

Overburdened prescriptive regulations in this area, especially so soon after last year's sweeping reforms, may do more harm than good for participants and providers alike. Too much information may actually prevent workers from seeing and understanding the information they genuinely need, and unmanageable requirements may force providers to pass along increased costs to workers or to leave the system entirely, a result that none of us would find acceptable.

Anyone who has installed computer software surely understands the danger of excessive or impractical disclosure. When presented with lengthy, nearly incomprehensible disclosure statements on your computer screen, do you thoroughly read each and every word? Or do you merely check the box that says "I understand" in order to get the program you need?

I am deeply concerned that if we are not careful, we could create a similar experience for employees trying to save for their retirement. If we provide them with volumes of information before we allow them to begin saving, do we run the risk that they merely check the box that says they understand? Worse, will the valuable information they need be buried within a document so lengthy as to be intimidating?

At the same time, we want plan sponsors to get the information they need from service providers so they can discharge their fiduciary duties as custodians of plan assets reasonably and responsibly as required by law. But overwhelming plan sponsors or overburdening service providers with extensive disclosure schemes that do not produce meaningful information will serve only to increase costs, which will take money out of the pockets of retirees. Certainly, none of us support that.

Finally, we must consider any proposed changes within the broader context of existing regulatory efforts. The Congress does not operate in a vacuum. We must bear in mind the implications of existing law and regulation when it comes to complex new man-

dates. In that light, I am pleased that we have with us today the Assistant Secretary of Labor for Employee Benefits and Security, who will provide information about a number of regulatory initiatives directly relating to these issues that the Department has undertaken, some of which will become effective in the very near future.

If current efforts satisfy a large number of concerns regarding disclosure, we must ask if it is really necessary to proceed with legislation that may have unintended consequences. I believe there are a number of significant concerns in this arena, and I hope we explore them thoroughly today.

At the same time, I continue to keep an open mind about the broader issue of enhanced disclosure because it is an issue on which I believe we can find common ground. In that light, I hope that we can work together through an inclusive process, along with the groups and stakeholders affected by these reforms to determine whether legislation is necessary and, if so, craft legislation that creates the right balance.

I look forward to the testimony of today's witnesses and to a continued dialogue about the best way to protect and enhance retirement security for all Americans.

I yield back the balance of my time.

[The statement of Mr. McKeon follows:]

Prepared Statement of Hon. Howard P. "Buck" McKeon, Senior Republican Member, Committee on Education and Labor

Thank you, Chairman Miller, for convening this hearing. As you know, this Committee has been at the forefront when it comes to ensuring retirement security, and I'm pleased that you are continuing to focus on this critical issue.

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And surely, that must be our first imperative: do no harm.

Over-burdensome or proscriptive regulation in this area, especially so soon after last year's sweeping reforms, may do more harm than good for participants and providers alike. Too much information may actually prevent workers from seeing and understanding the information they genuinely need. And unmanageable requirements may force providers to pass along increased costs to workers or to leave the system entirely—a result that none of us would find acceptable.

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I believe there are a number of significant concerns in this arena, and I hope we explore them thoroughly today. At the same time, I continue to keep an open mind about the broader issue of enhanced disclosure, because it's an issue on which I believe we can find common ground. In that light, I hope that we can work together through an inclusive process, along with the groups and stakeholders affected by these reforms, to determine whether legislation is necessary and, if so, to craft legislation that strikes the right balance.

I look forward to the testimony of today's witnesses, and to a continued dialogue about the best way to protect and enhance retirement security for all Americans. I yield back the balance of my time.

Chairman MILLER. I thank the gentleman for his statement.

We are joined with an extraordinary panel of individuals who are very familiar with not only the legislation, but the underlying concerns. We are joined by Bradford P. Campbell who has served as Assistant Secretary of Labor for the Employee Benefits Security Administration since August of 2007. Mr. Campbell previously served a number of roles in the Department of Labor since 2001.

David Certner is the director of legislative policy for government relations and advocacy at AARP. Mr. Certner has been with AARP since 1992, and he served as chairman of the 1994 ERISA Advisory Council for the Department of Labor.

Tommy Thomasson is the co-founder and president and CEO of Daily Access Corporation, as well as the founder and president of Interserve, LLC. He also serves as chairman of the Council of Independent 401(k) Recordkeepers.

Lew Minsky is the senior attorney of employee benefit plans for Florida Light and Power. Mr. Minsky serves on the ERISA Industry Committee's Retirement Security Committee and the Profit-Sharing 401(k) Council of the American Board of Directors. I got that all out.

Jon Chambers is a principal at Schultz Collins Lawson Chambers, and he specializes in the analysis and design and implementation of investment programs for retirement plans. Mr. Chambers has served on the board of the Western Pension and Benefits Conference.

Welcome to all of you to the committee. Your full statements will be put in the record in their entirety. We will begin with you, Mr. Secretary. I think you know the routine here. There will be a green light when you start for 5 minutes, and then an orange light when we would like you to wrap up, and a red light when we would like you to finish, but we want you to finish your thoughts and complete thoughts.

So thank you and welcome to the committee.

STATEMENT OF BRADFORD P. CAMPBELL, ASSISTANT SECRETARY OF LABOR, EMPLOYEE BENEFITS SECURITY ADMINISTRATION, U.S. DEPARTMENT OF LABOR

Mr. CAMPBELL. Thank you very much, Mr. Chairman, Mr. McKeon and the other members of the committee. I very much appreciate this opportunity to come and testify about the Department of Labor's significant progress in promulgating regulations to improve the disclosure of fee expense and conflict-of-interest information in 401(k) and other employee benefit plans. Our regulatory initiatives in this area are a top priority for the Department.

Over the past 20 years, the retirement plan universe has changed in some very significant ways. They have affected both plan participants and plan fiduciaries. More workers now control the investment of their retirement savings in participant-directed individual account plans such as 401(k) plans. At the same time, the financial services marketplace has increased in complexity. Plan fiduciaries who are charged by law with the responsibility of making prudent decisions when hiring service providers and paying only reasonable expenses in doing so, have found their jobs more difficult as the number and types of fees proliferate and as relationships between financial service providers become more complex.

All of these trends cause the Department to conclude that despite the success we have been having with our education and outreach activities to educate fiduciaries and participants, that a new regulatory framework was necessary to better protect the interests of America's workers, retirees and their families. That is why we initiated three major regulatory projects, each addressing a different aspect of this problem.

The first regulation addresses the needs of participants for concise, useful, comparative information about their plan's investment options, to help them make informed decisions.

The second addresses the needs of plan fiduciaries who require more comprehensive disclosures by service providers to enable them to carry out their duties under the law and assess whether the cost that they are paying for the services they are receiving are reasonable and necessary.

The third regulation addresses disclosures made by plan administrators to the public and the federal regulators in the Form 5500, the annual report filed by pension plans.

I think it is essential, Mr. Chairman, to understand that the disclosure needs of these groups are different, and that therefore the disclosures that we would mandate via regulatory process would, in turn, be quite different. Participants are trying to choose and investment option from a defined universe of options within their plan. To do this, they need concise summary information to allow them to compare these options in meaningful ways. That includes information about fees, about the historical rates of return, the nature of these investments and other relevant factors in making those decisions.

Plan fiduciaries are trying to decide if the services that they are receiving and the prices they are being charged are reasonable and necessary. They are taking into account the needs of the plan as

a whole. They need to know whether the services provided are influenced by compensation arrangements between the service providers and third parties. They need to know what services are being provided and whether those services are necessary, and conduct that evaluation. The process by which they make these prudent decisions of necessity requires a more comprehensive and detailed disclosure.

In response to our request for information on participant disclosures, which we issued earlier this spring, there seems to be a basic agreement among all parties, and I believe it is an interest shared by the members of this committee as well, that participants generally are not going to benefit from voluminous, lengthy disclosures. As Mr. McKeon mentioned, the software agreement analogy is an apt one.

Also, it is important to recognize that participants bear the cost of producing these materials. If we produce disclosures that are voluminous and ignored, we have perversely increased the fees that participants pay without gaining a material advantage.

I want to emphasize that we are not at the beginning of this regulatory process. In fact, we have been working on it for quite some time and are well underway and quite advanced in it. We proposed the first regulation of these three in July of 2006, dealing with public disclosures, and we will be promulgating a final regulation on this within the next few weeks. We have completed drafting and we have submitted into the regulatory clearance process within the administration a proposed regulation providing the comprehensive disclosures required for fiduciaries. This will be published within the next several months. As I mentioned, we concluded the RFI on participant disclosures, and we will be issuing a proposed regulation later in the winter based on the information that we have gathered there as we developed this regulation.

I commend this committee for sharing our commitment and belief in the importance of enhanced disclosures, but I do think it is important to understand that it is not necessary from the Department's perspective to have a legislative change to complete the regulations we have underway. The current statute provides us with the authority to embark on these regulations and to conclude them.

I also think that there are many technical issues presented in compiling these disclosures, and the regulatory process is well suited to resolving some of those technical concerns. It is deliberative, open, and inclusive, and has been working well. I think we have heard from many of the other witnesses on this panel as we have gone through our deliberations at the Department.

If the committee does decide to pursue legislation, however, I would ask that it bear in mind the work that we have already done in its efforts, and that it also bear in mind the need for participants to receive concise disclosures and evaluate the legislation as introduced in that light. I am also somewhat concerned about the mandate of a particular type of investment option for 401(k) plans, as this is a departure from how ERISA has traditionally worked and impinges on the ability of participants and employers to together decide what is a mutually appropriate plan environment.

But in conclusion, Mr. Chairman, I would like to thank you for your interest in this and for the other members of the committee,

because this is a very important issue, and it is one that we take very seriously. I am committed to completing our regulatory projects in a timely manner.

I would be happy to answer any questions you have.

[The statement of Mr. Campbell follows:]

Prepared Statement of Bradford P. Campbell, Assistant Secretary of Labor

Good morning Chairman Miller, Ranking Member McKeon, and Members of the Committee. Thank you for inviting me to discuss 401(k) plan fees, the Department of Labor's role in overseeing plan fees, and proposals to increase transparency and disclosure of plan fee and expense information. I am Bradford Campbell, the Assistant Secretary of Labor for the Employee Benefits Security Administration (EBSA). I am proud to be here today representing the Department of Labor and EBSA. Our mission is to protect the security of retirement, health and other employee benefits for America's workers, retirees and their families, and to support the growth of our private benefits system.

Ensuring the security of retirement benefits is a core mission of EBSA, and one of this Administration's highest priorities. Excessive fees can undermine retirement security by reducing the accumulation of assets. It is therefore critical that plan participants directing the investment of their contributions, and plan fiduciaries charged with the responsibility of prudently selecting service providers and paying only reasonable fees and expenses have the information they need to make appropriate decisions.

That is why the Department began a series of regulatory initiatives last year to expand disclosure requirements in three distinct areas:

1. Disclosures by plans to participants to assist in making investment decisions;
2. Disclosures by service providers to plan fiduciaries to assist in assessing the reasonableness of provider compensation and potential conflicts of interest; and
3. More efficient, expanded fee and compensation disclosures to the government and the public through a substantially revised, electronically filed Form 5500 Annual Report.

Each of these projects addresses different disclosure needs, and our regulations will be tailored to ensure that appropriate disclosures are made in a cost effective manner. For example, participants are unlikely to find useful extensive disclosure documents written in "legalese"—instead, it appears from comments we received thus far that participants want concise and readily understood comparative information about plan costs and their investment options. By contrast, plan fiduciaries want detailed disclosures in order to properly carry out their duties under the law, enabling them to understand the nature of the services being provided, all fees and expenses, any conflicts of interest on the part of the service provider, and indirect compensation providers may receive in connection with the plan's business.

We have made significant progress on these projects. We will be issuing a final regulation requiring additional public disclosure of fee and expense information on the Form 5500 within the next few weeks. A proposed regulation requiring specific and comprehensive disclosures to plan fiduciaries by service providers is currently in the clearance process, and we expect this proposal to be published this year. We also concluded a Request for Information seeking the views of the interested public on issues surrounding disclosures to participants. We are currently evaluating the comments received from consumer groups, plan sponsors, service providers and others as we develop a proposed regulation.

The Employee Retirement Income Security Act of 1974 (ERISA) provides the Secretary with broad regulatory authority, enabling the Department to pursue these comprehensive disclosure initiatives without need for a statutory amendment. The regulatory process currently underway ensures that all voices and points of view will be heard and provides an effective means of resolving the many complex and technical issues presented. While I am pleased that we share the common goal of improving fee disclosure, I am concerned by a number of provisions in H.R. 3185, which I fear could disrupt our ongoing efforts to provide these important disclosures to workers. In addition, the legislation would fundamentally change the nature of ERISA's fiduciary oversight by mandating inclusion of Department of Labor-approved investment products, limiting the ability of workers and employers to develop plans that best suit their mutual needs. I am also concerned that the legislation may not achieve the primary goal of participant disclosures—providing workers with useful and concise information—by mandating very detailed and costly disclosure documents. Disclosures intended for participants should illuminate, not confuse—excessively detailed disclosures are likely to be ignored by participants even

as those participants bear the potentially significant cost of the preparation and distribution. In addition to these concerns, there are a number of issues regarding the practicality of administering the legislation's requirements.

My testimony today will discuss in more detail the Department's activities related to plan fees. Also, I will describe the Department's regulatory and enforcement initiatives focused on improving the transparency of fee and expense information for both plan fiduciaries and participants.

Background

EBSA is responsible for administering and enforcing the fiduciary, reporting, and disclosure provisions of Title I of ERISA. EBSA oversees approximately 683,000 private pension plans, including 419,000 participant-directed individual account plans such as 401(k) plans, and millions of private health and welfare plans that are subject to ERISA.[1]

Participant-directed individual account plans under our jurisdiction hold over $2.2 trillion in assets and cover more than 44.4 million active participants. Since 401(k)-type plans began to proliferate in the early 1980s, the number of employees investing through these types of plans has grown dramatically. The number of active participants has risen almost 500 percent since 1984 and has increased by 11.4 percent since 2000. EBSA employs a comprehensive, integrated approach encompassing programs for enforcement, compliance assistance, interpretive guidance, legislation, and research to protect and advance the retirement security of our nation's workers and retirees.

Title I of ERISA establishes standards of fiduciary conduct for persons who are responsible for the administration and management of benefit plans. It also establishes standards for the reporting of plan related financial and benefit information to the Department, the IRS and the PBGC, and the disclosure of essential plan related information to participants and beneficiaries.

The Fiduciary's Role

ERISA requires plan fiduciaries to discharge their duties solely in the interest of plan participants and beneficiaries, and for the exclusive purpose of providing benefits and defraying reasonable expenses of plan administration. In discharging their duties, fiduciaries must act prudently and in accordance with the documents governing the plan. If a fiduciary's conduct fails to meet ERISA's standards, the fiduciary is personally liable for plan losses attributable to such failure.

ERISA protects participants and beneficiaries, as well as plan sponsors, by holding plan fiduciaries accountable for prudently selecting plan investments and service providers. In carrying out this responsibility, plan fiduciaries must take into account relevant information relating to the plan, the investment, and the service provider, and are specifically obligated to consider fees and expenses.

ERISA prohibits the payment of fees to service providers unless the services are necessary, are provided pursuant to a reasonable contract, and the plan pays no more than reasonable compensation. Thus, plan fiduciaries must ensure that fees paid to service providers and other expenses of the plan are reasonable in light of the level and quality of services provided. Plan fiduciaries must also be able to assess whether revenue sharing or other indirect compensation arrangements create conflicts of interest on the part of the service provider that might affect the quality of the services to be performed. These responsibilities are ongoing. After initially selecting service providers and investments for their plans, fiduciaries are required to monitor plan fees and expenses to determine whether they continue to be reasonable and whether there are conflicts of interest.

EBSA's Compliance Assistance Activities

EBSA assists plan fiduciaries and others in understanding their obligations under ERISA, including the importance of understanding service provider fees and relationships, by providing interpretive guidance[2] and making related materials available on its Web site. One such publication developed by EBSA is Understanding Retirement Plan Fees and Expenses, which provides general information about plan fees and expenses. In conjunction with the Securities and Exchange Commission, we also developed a fact sheet, "Selecting and Monitoring Pension Consultants—Tips for Plan Fiduciaries." This fact sheet contains a set of questions to assist plan fiduciaries in evaluating the objectivity of pension consultant recommendations.

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[1] Based on 2004 filings of the Form 5500.

[2] See, e.g., Field Assistance Bulletin 2002-3 (November 5, 2002) and Advisory Opinions 2003-09A (June 25, 2003), 97-16A (May 22, 1997), and 97-15A (May 22, 1997).

EBSA also has made available on its Web site a model "401(k) Plan Fee Disclosure Form" to assist fiduciaries of individual account pension plans when analyzing and comparing the costs associated with selecting service providers and investment products. This form is the product of a coordinated effort of the American Bankers Association, Investment Company Institute, and the American Council of Life Insurers.

To help educate plan sponsors and fiduciaries about their obligations under ERISA, EBSA conducts numerous educational and outreach activities. Our campaign, "Getting It Right—Know Your Fiduciary Responsibilities," includes nationwide educational seminars to help plan sponsors understand the law. The program focuses on fiduciary obligations, especially related to the importance of selecting plan service providers and the role of fee and compensation considerations in that selection process. EBSA has conducted 20 fiduciary education programs since May 2004 in different cities throughout the United States. EBSA also has conducted 49 health benefits education seminars, covering nearly every state, since 2001. Beginning in February 2005, these seminars added a focus on fiduciary responsibilities. EBSA will continue to provide seminars in additional locations under each program.

Disclosures to Participants under Current Law

ERISA currently provides for a number of disclosures aimed at providing participants and beneficiaries information about their plans' investments. For example, information is provided to participants through summary plan descriptions and summary annual reports. Under the Pension Protection Act of 2006, plan administrators are required to automatically furnish pension benefit statements to plan participants and beneficiaries. The Department issued a Field Assistance Bulletin in December 2006 to provide initial guidance on complying with the new statutory requirements. Statements must be furnished at least once each quarter, in the case of individual account plans that permit participants to direct their investments, and at least once each year, in the case of individual account plans that do not permit participants to direct their investments. Other disclosures, such as copies of the plan documents, are available to participants on request.

Additional disclosures are required by the Department's rules concerning whether a participant has "exercised control" over his or her account. ERISA section 404(c) provides that plan fiduciaries are not liable for investment losses which result from the participant's exercise of control. A number of conditions must be satisfied, including that specified information concerning plan investments must be provided to plan participants. Information fundamental to participants' investment decisions must be furnished automatically. Additional information must be provided on request.

EBSA Participant Education and Outreach Activities

EBSA is committed to assisting plan participants and beneficiaries in understanding the importance of plan fees and expenses and the effect of those fees and expenses on retirement savings. EBSA has developed educational brochures and materials available for distribution and through our Web site. EBSA's brochure entitled A Look at 401(k) Plan Fees for Employees is targeted to participants and beneficiaries of 401(k) plans who are responsible for directing their own investments. The brochure answers frequently asked questions about fees and highlights the most common fees, and is designed to encourage participants to make informed investment decisions and to consider fees as a factor in decision making. Last fiscal year, EBSA distributed over 5,400 copies of this brochure and over 46,000 visitors viewed the brochure on our Web site.

More general information is provided in the publications, What You Should Know about Your Retirement Plan and Taking the Mystery out of Retirement Planning. In the same period, EBSA distributed over 86,000 copies of these two brochures and almost 102,000 visitors viewed these materials on our Web site. EBSA's Study of 401(k) Plan Fees and Expenses, which describes differences in fee structures faced by plan sponsors when they purchase services from outside providers, is also available.

Regulatory Initiatives

EBSA currently is pursuing three initiatives to improve the transparency of fee and expense information to participants, plan sponsors and fiduciaries, government agencies and the public. We began these initiatives, in part, to address concerns that participants are not receiving information in a format useful to them in making investment decisions, and that plan fiduciaries are having difficulty getting needed fee and compensation arrangement information from service providers to fully satisfy their fiduciary duties. The needs of participants and plan fiduciaries are grow-

ing as the financial services industry evolves, offering an increasingly complex array of products and services.

• *Disclosures to Participants*

EBSA currently is developing a proposed regulation addressing required disclosures to participants in participant-directed individual account plans. This regulation will ensure that participants have concise, readily understandable information they can use to make informed decisions about the investment and management of their retirement accounts. Special care must be taken to ensure that the benefits to participants and beneficiaries of any new requirement outweigh the compliance costs, given that any such costs are likely to be charged against the individual accounts of participants.

On April 25, 2007, the Department published a Request for Information to gather data to develop the proposed regulation. The Request for Information invited suggestions from plan participants, plan sponsors, plan service providers, consumer advocates and others for improving the current disclosures applicable to participant-directed individual account plans and requesting analyses of the benefits and costs of implementing such suggestions. The Department specifically invited comment on the recommendation of the Government Accountability Office that plans be required to provide a summary of all fees that are paid out of plan assets or directly by participants, as well as other possible approaches to improving the disclosure of plan fee and expense information.

In connection with this initiative, EBSA is also working with the Securities and Exchange Commission to develop a framework for disclosure of information about fees charged by financial service providers, such as mutual funds, that would be more easily understood by participants and beneficiaries. Improved mutual fund disclosure would assist plan participants and beneficiaries because a large proportion of 401(k) plan assets are invested in mutual fund shares. We are working closely with the SEC to ensure that the disclosure requirements under our respective laws are complementary.

We are hopeful that improved fee disclosure will assist plan participants and beneficiaries in making more informed decisions about their investments. Better disclosure could also lead to enhanced competition between financial service providers which could lead to lower fees and enhanced services.

• *Disclosures to Plan Fiduciaries*

EBSA will shortly be issuing a proposed regulation amending its current regulation under section 408(b)(2) to clarify the information fiduciaries must receive and service providers must disclose for purposes of determining whether a contract or arrangement is "reasonable," as required by ERISA's statutory exemption for service arrangements. Our intent is to ensure that service providers entering into or renewing contracts with plans disclose to plan fiduciaries comprehensive and accurate information concerning the providers' receipt of direct and indirect compensation or fees and the potential for conflicts of interest that may affect the provider's performance of services. The information provided must be sufficient for fiduciaries to make informed decisions about the services that will be provided, the costs of those services, and potential conflicts of interest. The Department believes that such disclosures are critical to ensuring that contracts and arrangements are "reasonable" within the meaning of the statute. This proposed regulation currently is under review within the Administration.

• *Disclosures to the Public*

EBSA will shortly promulgate a final regulation revising the Form 5500 Annual Report filed with the Department to complement the information obtained by plan fiduciaries as part of the service provider selection or renewal process. The Form 5500 is a joint report for the Department of Labor, Internal Revenue Service and Pension Benefit Guaranty Corporation that includes information about the plan's operation, funding, assets, and investments. The Department collects information on service provider fees through the Form 5500 Schedule C.

Consistent with recommendations of the ERISA Advisory Council Working Group, the Department published, for public comment, a number of changes to the Form 5500, including changes that would expand the service provider information required to be reported on the Schedule C. The proposed changes more specifically define the information that must be reported concerning the "indirect" compensation service providers received from parties other than the plan or plan sponsor, including revenue sharing arrangements among service providers to plans. The proposed changes to the Schedule C were designed to assist plan fiduciaries in monitoring the reasonableness of compensation service providers receive for services and potential conflicts of interest that might affect the quality of those services. EBSA has com-

pleted its review of public comments on the proposed Schedule C and other changes to the Form 5500 and expects to have a final regulation and a notice of form revisions published by mid-October.

We intend that the changes to the Schedule C will work in tandem with our 408(b)(2) initiative. The amendment to our 408(b)(2) regulation will provide up front disclosures to plan fiduciaries, and the Schedule C revisions will reinforce the plan fiduciary's obligation to understand and monitor these fee disclosures. The Schedule C will remain a requirement for plans with 100 or more participants, which is consistent with long-standing Congressional direction to simplify reporting requirements for small plans.

EBSA's Enforcement Efforts

EBSA has devoted enforcement resources to this area, seeking to detect, correct and deter violations such as excessive fees and expenses, and failure by fiduciaries to monitor on-going fee structure arrangements. Over the past nine years, we closed 354 401(k) investigations involving these issues, with monetary results of over $64 million.

In carrying out its enforcement responsibilities, EBSA conducts civil and criminal investigations to determine whether the provisions of ERISA or other federal laws related to employee benefit plans have been violated. EBSA regularly works in coordination with other federal and state enforcement agencies, including the Department's Office of the Inspector General, the Internal Revenue Service, the Department of Justice (including the Federal Bureau of Investigation), the Securities and Exchange Commission, the PBGC, the federal banking agencies, state insurance commissioners, and state attorneys general.

EBSA is continuing to focus enforcement efforts on compensation arrangements between pension plan sponsors and service providers hired to assist in the investment of plan assets. EBSA's Consultant/Adviser Project (CAP), created in October 2006, addresses conflicts of interest and the receipt of indirect, undisclosed compensation by pension consultants and other investment advisers. Our investigations seek to determine whether the receipt of such compensation violates ERISA because the adviser or consultant used its status with respect to a benefit plan to generate additional fees for itself or its affiliates. The primary focus of CAP is on the potential civil and criminal violations arising from the receipt of indirect, undisclosed compensation. A related objective is to determine whether plan sponsors and fiduciaries understand the compensation and fee arrangements they enter into in order to prudently select, retain, and monitor pension consultants and investment advisers. CAP will also seek to identify potential criminal violations, such as kickbacks or fraud.

Concerns Regarding H.R. 3185

I applaud the Chairman's concern about enhancing participant disclosure and protection in 401(k)-type plans and his efforts to highlight the importance of this issue . But while H.R. 3185 and the Department's regulatory initiatives share the common goal of providing increased transparency of fee and expense information, I am concerned that the legislation could disrupt the Department's ongoing efforts to provide these important disclosures.

- *Participant Disclosure Requirements*

Unlike plan fiduciaries, who require highly detailed fee, expense and conflict of interest information to carry out their duties, participants are most likely to benefit from concise disclosures that allow them to meaningfully compare the investment options in their plans. In response to our April Request for Information, the Department received many comments highlighting the importance of brevity and relevance in disclosures to participants. For example, AARP cautioned that "To be effective, investment and fee disclosures should be short, easy to read and provide meaningful information," and cited several studies supporting shorter, more concise disclosure materials.[3]

The very detailed scope of H.R. 3185's disclosure requirements could result in many participants ignoring the complicated disclosures. For example, under the bill as introduced, the first of several disclosures participants would receive is an annual notice containing a list of specific disclosure items, including a "fee menu." The fee menu, which would list all potential fees that could be assessed, would divide all potential fees into one of three categories, and then further divide the fees within

[3] Letter from David Certner, Legislative Counsel and Director of Legislative Policy, Government Relations and Advocacy, AARP, to the Employee Benefits Security Administration (July 24, 2007), at page 9, available at *http://www.dol.gov/ebsa/pdf/Certner072407.pdf.*

each of the three categories into one of four subcategories. Each fee within the twelve subcategories would be accompanied by a "general description of the purposes for each fee." This could result in a complex disclosure that describes literally dozens of potential fees, regardless of their relevance to the participant's decision in selecting an investment option. One tool for plan fiduciaries developed jointly by a number of financial service providers lists more than 100 different kinds of fees and expenses common to 401(k)-type plans—categorizing and describing each of these fees could result in a very lengthy disclosure document. Many commenters, in response to our Request for Information, suggested that one or more methods of aggregating fee information would provide participants with more meaningful and useful disclosure.

- *Mandated Investment Options*

The legislation also takes an unprecedented step by requiring the Department of Labor to approve by regulation a mandatory investment option for all participant-directed individual account plans. In addition to limiting the ability of workers and employers to develop plans that best suit their mutual needs, this provision would result in the Labor

Department dictating which "nationally-recognized market-based index funds" are eligible for mandatory inclusion by plans. Plan fiduciaries—accountable for their decisions and acting in a transparent, efficient marketplace—should select service providers rather than a Federal agency. Further, the criteria for eligible index funds are not defined. Funds must offer a combination of returns, risk and fees "that is likely to meet retirement income needs at adequate levels of contribution," but it is not clear from this language what standard the Department should use in determining what "retirement income needs" or "adequate levels of contribution" are.

- *Provision of "Services" to Small Employers*

The Department of Labor is very active in providing education and compliance assistance to plan sponsors, and focuses specifically on the needs of small employers. For example, we developed publications such as 401(k) Plans for Small Businesses, Choosing a Retirement Solution for Your Small Business, SIMPLE IRA Plans for Your Small Business, and conduct year-round fiduciary education seminars that are particularly designed for small employers. However, the legislation goes beyond education and outreach, requiring the Department to provide "services designed to assist small employers in finding * * * affordable investment options." I am concerned that this provision may well conflict with the Department's duty to enforce the law, as both the plans and the service providers could be potential targets of our investigations.

While the Department has a number of concerns in addition to the three specific issues discussed above, such as the duplicative nature of the new advisory body created by the bill and the requirement to "widely disseminate" the names of certain noncompliant service providers to more than 400,000 plans and nearly 45 million participants, we will provide technical comments to the Committee addressing these issues at a later time.

Conclusion

Mr. Chairman and Members of the Committee, thank you for the opportunity to testify before you today. The Department is committed to ensuring that 401(k) plans and participants pay fair, competitive and transparent prices for services that benefit them—and to combating instances where fees are excessive or hidden. We are moving as quickly as possible consistent with the requirements of the regulatory process to complete our disclosure initiatives, and we believe they will improve the retirement security of America's workers, retirees and their families. I will be pleased to answer any questions you may have.

Chairman MILLER. Thank you.

Mr. Certner?

STATEMENT OF DAVID CERTNER, LEGISLATIVE COUNSEL AND LEGISLATIVE POLICY DIRECTOR, AARP

Mr. CERTNER. Thank you, Mr. Chairman and members of the committee. I am David Certner, the legislative counsel and legislative policy director at AARP. Thank you for convening this hearing. We appreciate the opportunity to discuss the important issues

raised in the 401(k) Fair Disclosure for Retirement Security Act of 2007.

AARP believes that all workers need access to a retirement plan in addition to Social Security. In 2006, there were approximately 50 million active participants in 401(k) plans, which are now the dominant employer-based pension vehicle. Those participating in these plans shoulder the risk and the responsibility for their investment choices, and ultimately their retirement. As a result, better plan information is essential.

We all have a stake in ensuring that participants receive accurate and informative disclosures from their 401(k) plan, including expenses. However, plan expense and fee information is often scattered or difficult to access or nonexistent. Meaningful information is vital because fees significantly reduce the assets available for retirement. Plan fees compound over time and the larger the fee, the bigger the reduction.

As you noted earlier, GAO recently estimated that $20,000 left in a 401(k) account that had a 1 percentage point higher fee for 20 years would result in an over 17 percent reduction, or over $10,000 in the account balance. We estimate that over a 30-year period, the account would be about 25 percent less. Even a difference of over 0.5 percent, 50 basis points, reduced the value of the account by 13 percent over 30 years.

In short, fees and expenses can have a huge impact on the retirement income security levels. AARP recently surveyed 401(k) participants to gauge their understanding of plan fees in investment choices. Our survey indicates that participants don't have a clear understanding of their investments. When asked if they know the names of all the funds in which they have money invested through the 401(k) plan, almost 65 percent of survey respondents said no; 27 percent didn't know whether their plan offered a stock fund; 29 percent didn't know if the plan had a bond fund.

In addition, many 401(k) participants lack basic knowledge of plan fees. When asked whether they pay any fees for their plan, less than one-fifth said they did. Almost two-thirds responded that they don't pay fees, and 18 percent said they didn't know.

Respondents were questioned in detail about the fees that may be charged for mutual funds and other types of investments. The answers indicate that 401(k) participants do not fully understand what types of fees their plans charge. For example, when asked whether their 401(k) plan charged an administrative fee, 24 percent said yes, 21 percent no, and 55 percent said they didn't know. Finally, when they were told that plans often charge fees, 83 percent said they didn't know how much they paid in fees.

It is clear that better information is needed. We applaud the introduction of H.R. 3185, which would require greater transparency of fee and expense information for both participants and plan sponsors.

Comprehensive information on plan fees and expenses will enable plan sponsors to fulfill their fiduciary responsibility to ensure that fees and expenses are reasonable. H.R. 3185 would establish a solid framework for providing that information to them. Employers who are doing due diligence need to have access to costs associated with various components, not just total costs. Requiring serv-

ice providers to give comprehensive information to plan sponsors is important to participants, since the costs are often passed directly on to them.

Clear information is also necessary for participants to better manage their own accounts. Participants face a range of potential fees. And while these fees vary in scope and size, they have one thing in common: they all reduce the level of assets available for retirement. H.R. 3185 would require notice to participants of plan investment choices, including the risks and fees.

We recommend that information on the investment fees also demonstrate how they impact the balance over time. We believe that all individual account participants need to have access to investment and fee information. I would also add that the legislation's comprehensive annual benefits statement would provide a more complete picture of a participant's 401(k) status.

We commend you, Mr. Chairman, for introducing this bill to strengthen 401(k) disclosures. The significant impact of fees on retirement security highlights the need for clear investment and fee information. We think that the greater disclosure that is required under this legislation would help to drive down fees and enable plan sponsors and plan participants to be better consumers, and will ultimately lead to greater retirement income security.

We look forward to working with this committee to ensure that employers and participants have the information they need.

Thank you for the opportunity to testify.

[The statement of Mr. Certner follows:]

Prepared Statement of David Certner, Legislative Counsel and Legislative Policy Director, AARP

Mr. Chairman and members of the Committee, I am David Certner, Legislative Counsel and Legislative Policy Director at AARP. Thank you for convening this hearing on comprehensive, informative and timely disclosure of 401(k) plan investments and fees. AARP appreciates the opportunity to discuss this important issue, as well as H.R. 3185, the 401(k) Fair Disclosure for Retirement Security Act of 2007.

With more than 39 million members, AARP is the largest organization representing the interests of Americans age 50 and older and their families. About half of AARP members are working either full-time or part-time. All workers need access to a retirement plan that supplements Social Security's solid foundation. For those who participate in a defined contribution plan, such as a 401(k), better and easy to understand information is essential to help them make sound plan decisions. This is especially true for plans in which the participants have investment choices to make. Informed decision-making is key to future retirement income security.

There were approximately 50 million active participants in 401(k) plans in 2006, and overall, 401(k) plans held more than $2.7 trillion dollars in assets.[1] These plans have become the dominant employer-based pension vehicle. We all have a stake in ensuring that participants receive timely, accurate, and informative disclosures from their 401(k) plans—the better the understanding of how the plan operates, the better participants will be able to prepare for retirement. Today, it is clear that better disclosure of fee information is needed. The fee information participants currently receive about their plan is often scattered among several sources, difficult to access, or nonexistent. Even if it is accessible, plan investment and fee information is not always presented in a way that is meaningful to participants.

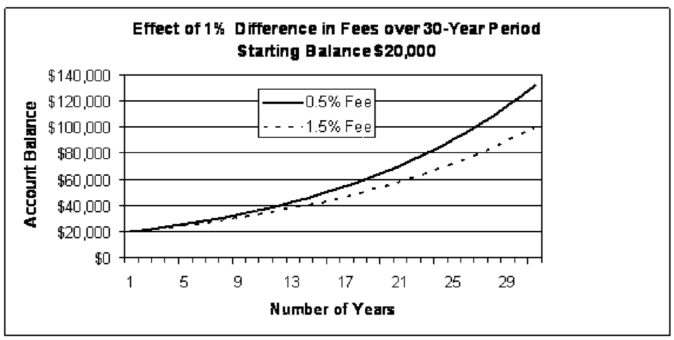
Meaningful and easy to understand information is vital because the fees and expenses charged to participants significantly reduce the amount of assets available for retirement. Plan fees compound over time and the larger the fee, the bigger the bite that is ultimately taken out of the participant's retirement nest egg. Both plan sponsors and participants need to have the right information in order to make deci-

[1] EBRI Issue Brief No. 308, August 2007.

sions that safeguard the plan's retirement income returns and enhance workers' retirement savings.

Some have suggested that added focus on fees and expenses is not important, that such costs do not add up to a significant impact. After all, even an additional 1% in fees—100 basis points—is only $1.00 out of every hundred dollars. But this argument understates the impact that fees and expenses have on total return, especially compounded over long periods of time.

The U.S. Government Accountability Office (GAO) recently estimated that $20,000 left in a 401(k) account for 20 years could grow to $70,555 at 7% interest return minus a 0.5 percent charge for fees (6.5% net return). The same $20,000 would grow to only about $58,400 if the annual fees are 1.5% (5.5% net return).[2] The one percent fee differential has a dramatic impact—resulting in an over 17 percent reduction in the account balance over the 20-year period. Using GAO assumptions, AARP has estimated that over a longer 30-year period, the same $20,000 with a 0.5 percent charge would grow to $132,287, while a charge of 1.5 percent would reduce that growth to $99, 679—about a 25 percent reduction in the account balance. Even a difference of only 50 basis points, from 0.5 percent to 1.0 percent, would reduce the value of the account by $17,417, or a little over 13 percent over the 30-year period.



The chart assumes a 7 percent rate of return before fees are assessed.

Clear, usable information about plan investments and fees will help plan sponsors fulfill their fiduciary responsibility and avoid potential fiduciary concerns. It is important that there be greater transparency of fees and other expense information in order for plan sponsors to make prudent choices. Employers are obligated to ensure that fees paid to service providers and other plan expenses are reasonable, and they are required to monitor these expenses over time. Employers doing due diligence need to have access to costs associated with various components, not just total costs. This responsibility is of great importance for participants, since costs are often passed directly on to them.

In order to better manage their own accounts, individuals also need greater disclosure to better understand the numerous fees and expenses in the plan. Participants face a range of potential fees, including plan administration fees, investment fees and fees for individual plan services. Within these categories are a range of potential fees. For example, plan investment choices may include sales charges and investment advisory fees. The level of these fees can vary greatly depending on plan size and service provided. But these fees all have one thing in common—they will reduce the level of assets available for retirement.

Sound information can also provide participants with better tools to enforce their rights under the plan, including recovering lost benefits as a result of a breach of fiduciary duty. At least a dozen cases involving 401(k) fees have been filed in federal district courts, claiming fiduciary violations with respect to plan administration. The complaints center on allegations that 401(k) plans incurred unreasonable and excessive fees that were not adequately disclosed to participants.

Given the importance of fee information to both plan sponsors and plan participants, we applaud introduction of the 401(k) Fair Disclosure for Retirement Security Act of 2007 (H.R. 3185) by Chairman Miller. The legislation would require greater transparency of fee and expense information for both plan sponsors and plan participants. The greater disclosure required under this legislation will help drive down

[2] Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information, GAO-07-21 (November 2006).

fees in the marketplace, will enable plan sponsors and plan participants to be better consumers, and will ultimately lead to greater retirement income security.

AARP's Survey Results: Participants' Understanding of Fees

While plan participants have been asked to take on more risk and responsibility for their 401(k) plan, they often find the plan investment choices, as well as their associated fees and expenses, a mystery. AARP recently surveyed 1,584 401(k) participants to gauge their understanding of the fees they pay and the factors they consider in selecting the investments offered by their plans. "401(k) Participants' Awareness and Understanding of Fees, July 2007" indicates that participants do not always have a clear grasp of the investment options offered by their plans or what they are invested in. When asked if they know the names of all the funds in which they have money invested through the 401(k) plan, almost 65% of survey respondents said no. And, when types of investments were described, survey respondents did not always know whether they had money in that investment. For example, 27% did not know whether their plan offered a stock fund and about as many, 29%, did not know whether their plan had a bond fund. 401(k) participants would benefit from additional information about the investment options in the plan.

When asked about the sources of information used to make investment decisions, 57% of respondents who make investment decisions for their 401(k) plan indicate they refer to a summary of the plan's investment choices. Other sources include prospectuses (34%), research analysts' recommendations (22%), financial articles (17%), and televised financial broadcasts (14%). The fact that more than half of the respondents consulted the plan's summary of investment materials helps emphasize the importance of plan-provided summary information.

In addition, many 401(k) participants lack basic knowledge of the fees associated with their plan. When asked whether they pay any fees for their 401(k) plan, less than one-fifth (17%) said they do pay fees. Almost two-thirds responded that they do not pay fees (65%) and 18% stated that they do not know.

When told that 401(k) providers often charge fees for administering the plans and that the fees may be paid by the employer as a sponsor or by the participants in the plan, 83% of those surveyed acknowledged that they do not know how much they pay in fees, while 17% said they did.

Respondents were questioned in some detail about the kinds of fees that may be charged for mutual funds and other types of investments. The answers indicate that 401(k) participants do not necessarily understand what types of fees their plans are charging. For example, when asked whether their 401(k) plan charged an administrative fee, 24% said yes, 21% said no, and 55% replied that they did not know. A similar question was posed about redemption fees. Seven percent of the survey respondents said they were charged a redemption fee, but 27% replied that they were not and 65% did not know.

When participants were provided possible definitions of an administrative and a redemption fee, 51% of the respondents correctly identified the administrative fee and 38% correctly identified the redemption fee. Approximately one third (37%) stated they did not know which statement correctly identified an administrative fee and more than half (55%) said they did not know which statement correctly identified a redemption fee.

The 401(k) Fair Disclosure for Retirement Security Act of 2007

The 401(k) Fair Disclosure for Retirement Security Act of 2007 (H.R. 3185) would ensure that 401(k) service providers provide plan sponsors with comprehensive information on service fee and expense information. The bill would also require notice to participants of investment option information, including risk and fees to the participant. It would create a new annual benefit statement and require that at least one plan investment option be a nationally recognized market-based index fund.

H.R. 3185 would establish a solid framework for providing comprehensive information to plan sponsors that could then be synthesized and given to participants along with required investment option information. In establishing itemization of different categories of fees, bundled service arrangements would essentially have to be un-bundled for clearer presentation of the costs. Requiring that plan service providers give comprehensive information to plan sponsors will provide the plan sponsors with the resources they need to fulfill their fiduciary duties.

H.R. 3185 would not extend disclosure requirements to all individual account plans, just 401(k) plans. Participants in other individual account plans, such as ERISA-covered 403(b) plans, are also subject to investment costs or administrative fees, and those participants have a right to know what is being charged to their accounts. AARP urges that all individual account plan participants have access to investment and fee information.

The provision establishing a new annual benefit statement would provide a comprehensive picture of a participant's status in the 401(k) plan. This provision will need to be coordinated with the new Pension Protection Act requirements for a quarterly benefit statement in order to enhance consistency and effectiveness of the information.

AARP supports the bill's requirement that the plan investment options include a nationally recognized market-based index fund. This option would ensure that all plans provide participants with access to the market at the generally lower expense levels associated with index funds.

AARP recommends that information on an investment's fees demonstrate how they will affect the participant's account balance over time. Participants need to know how fees and expenses of an investment compare with others offered by the plan as well as similar investments in the market. GAO recently suggested that participants be provided the expense ratio for each investment as an effective way to compare fees, especially within the context of the investment's risk and historical performance.[3]

AARP also recommends including in the information furnished to participants whether employer stock is an investment option because the plan terms so provide. Too many employees continue to hold excessively large amounts of employer stock in their 401(k) plans. Clarifying why employer stock is among the available choices may help participants choose investments that reflect their personal goals, rather than reflect a value judgment about the return or risk associated with the employer stock. H.R. 3185 already includes a provision requiring that employer stock fees be included in the disclosure to participants. This information, which would complement the Pension Protection Act's provisions on disclosure and diversification, would add additional context to the information about employer stock that would help participants make a more informed decision.

Conclusion

AARP commends Congressman Miller for introducing H.R. 3185 to strengthen investment and fee disclosures to 401(k) sponsors and participants. The legislation represents an important step to require necessary information and ensure that it is effectively communicated. The significant impact of fees on retirement security, as well as the results of AARP's survey of 401(k) participants, highlights the need for clear investment and fee information. We look forward to working with this Committee to ensure that both employers and participants have the information they need to best ensure an adequate retirement income level.

Thank you for the opportunity to testify today.

Chairman MILLER. Thank you very much for your testimony.

In the introductions, I skipped over Mr. Scanlon. My apologies to you, Mr. Scanlon. Mr. Scanlon is the head of Americas Institutional Business for Barclays Global Investors. He also serves on the finance board of City College of San Francisco and he received his master's in accounting from Northwestern University. Welcome to the committee. Thank you.

STATEMENT OF MATTHEW H. SCANLON, MANAGING DIRECTOR, BARCLAYS GLOBAL INVESTORS

Mr. SCANLON. Chairman Miller, Ranking Member McKeon and members of the committee, on behalf of Barclays Global Investors, I appreciate the opportunity to testify today regarding the 401(k) Fair Disclosure for Retirement Security Act of 2007.

Headquartered in San Francisco, BGI is one of the world's largest institutional asset managers. We have approximately $2 trillion in assets under management, including hundreds of billions of dollars of ERISA plan assets. BGI's services to its clients are focused on investment management. We do not provide other services such as recordkeeping.

[3] Changes Needed to Provide 401(k) Plan Participants and the Department of Labor Better Information, GAO-07-21 (November 2006).

An increasing number of Americans rely on employer-sponsored defined-contribution plans to help them accumulate the savings they need for retirement, but far too many 401(k) plans fail to achieve their purpose if they are meant to provide worker security in retirement. There are three main reasons for this: inadequate or no contributions into the plan; low investment returns with high fees; and a lack of distribution strategies to fund consumption in retirement.

The technology for saving and investing today to receive a benefit far in the future is already in use by well-managed defined benefit plans. We need to bring some of these practices into the DC marketplace and the bill under discussion today would take an important step in this direction.

I think we can all agree that the goal of any disclosure framework should be to provide relevant information in a cost-effective manner to enable the best possible decisions. Plan sponsors need adequate information about investment options, including their fees and expenses, so that they can exercise their fiduciary responsibility to choose the investment options available under the plan.

Plan sponsors also have the fiduciary obligation to choose other plan service providers and to understand the cost of those services. Today, the information the plan sponsor needs is sometimes difficult to obtain and difficult to compare. BGI supports legislative efforts to require service providers to provide specific disclosures by fee category so as to make plan sponsors' decision-making less burdensome.

Defined contribution plan service arrangements generally fall into two principal categories. The arrangements may be bundled, that is recordkeeping combined with asset management services together; or unbundled, where the plan sponsor selects its investment options separately from its recordkeeper and other service providers. Bundled service arrangements may be appropriate for some plans, particularly smaller ones, but even then the fee components of both recordkeeping and asset management must separately and clearly be disclosed.

Clear, comparable and fully disclosed information about these changes and these charges will allow the plan sponsor to more easily and adequately meets its fiduciary responsibility under ERISA to determine that the fees and expenses are reasonable. The most fundamental decisions that plan participants need to make are whether and at what level to participate in the plan; which investment options to choose; whether and when to change their investment allocations; and when to take distributions from the plan.

The bill requires plan sponsors to list every service fee assessed against the participant's account. We believe that the average participant might be better served with a summary of these charges grouped into categories with the additional detail available upon request or on the plan's website. Participant disclosures should provide a consistent, comparable measure of fee and expense information and should allow plan participants to easily understand investment performance after all fees and expenses are paid by the participant.

In addition, again in a comparable format, these disclosures should include the investment objective and strategy, key investment risks, and historical performance for each investment option.

We support the adoption by the Department of Labor of standardized fund fact sheets as the form of disclosure for plan participants. There are a broad variety of investment types that can be offered to plan participants in 401(k) plans, and they are subject to a variety of different regulatory regimes. We know of no regulatory impediment, however, to providing comparable disclosure to participants across all such investment types, regardless of legal structure.

We support the bill's conflict-of-interest disclosure requirements and urge that this provision be clarified to ensure that plan sponsors receive information that is specific to the plan sponsor and the particular service provider.

In conclusion, many DC plans currently have challenges with all three of the major components: the contribution or savings component; the investment performance component; and the retirement distribution component. By promoting such features as auto-enrollment and automatic contribution escalation, the Pension Protection Act of 2006 has already focused on the first challenge.

By promoting more effective disclosure of fees and expenses to plan sponsors and plan participants, the 401(k) Fair Disclosure for Retirement Security Act of 2007 would improve the second component. Transparency can be an important catalyst for making DC plans perform more like DB plans in the balance of costs and investment performance, and thereby improving the future income of all retirees.

I will welcome your questions. Thank you.

[The statement of Mr. Scanlon follows:]

Statement of Matthew H. Scanlan, CFA
Head of Americas Institutional Business, Barclays Global Investors, N.A.
Before the Committee on Education and Labor,
U.S. House of Representatives
October 4, 2007

On behalf of Barclays Global Investors (BGI), I appreciate the opportunity to testify today regarding H.R. 3185, the *401(k) Fair Disclosure for Retirement Security Act of 2007*. An increasing number of Americans rely on employer-sponsored defined contribution plans to help them accumulate the savings they will need for a secure retirement. But far too many 401(k) and other defined contribution (DC) plans fail to achieve their purpose, if they are meant to provide security in retirement for the workers who contribute to them. There are three main reasons for this: inadequate or no contributions into the plan; low investment returns with high fees; and lack of a distribution strategy to fund consumption in retirement. The technology for saving and investing today to receive a benefit far in the future is already in place, and is in use by well-managed defined benefit (DB) pension plans. We need to bring some of these practices into the DC marketplace, and the bill under discussion today would, if enacted, take an important step in this direction.

<u>Executive Summary</u>

Fees and expenses can over time significantly erode the amount of income available for a participant's retirement. Participants need clear information on fees and expenses in order to make informed selections from among the investment options provided in their plan. Participants, who are typically not experts in financial planning, would benefit most from summary categories rather than a long list of items which may confuse or discourage decision-making. Plan sponsors, however, require more and better information than is currently available. To fully evaluate potential investment options and service providers, and their appropriateness for the plan, sponsors must be given information which permits them to understand how each service provider is compensated, directly or indirectly. It is not enough for plan sponsors only to understand what fees and expenses are explicitly deducted from a participant's account, or paid from plan assets or by the sponsor itself.

Further, recordkeeping and other administrative expenses on one hand and asset management fees on the other must also be disclosed separately by service providers to plan sponsors: only then can sponsors determine that fees and expenses are reasonable, as required under the Employee Retirement Income Security Act (ERISA).

Background on BGI

BGI[1] was founded in 1971 as part of Wells Fargo Bank in San Francisco, California. Today, we are owned by Barclays PLC, one of the world's leading diversified financial services companies. We remain headquartered in San Francisco with approximately 1900 employees in California and elsewhere in the U.S. and 1800 worldwide serving the needs of our global clients. With approximately $2 trillion in assets under management, BGI, together with its affiliates, is one of the world's largest institutional asset managers, and is the largest provider of structured investment strategies, such as index, tactical asset allocation and quantitative active strategies. BGI pioneered the first institutional index fund strategy in 1971, and has continued a tradition of financial innovation ever since—including the creation of the concept of a target date retirement (lifecycle) fund and the launch of the first lifecycle fund in the early 1990's.

Since its founding, BGI has remained true to a single global investment philosophy, which we call *Total Performance Management*. BGI manages *performance* through the core disciplines of *risk, return,* and *cost* management. The success of our investing methodology results from our focus on delivering superior investment returns over time while minimizing trading and other implementation costs and rigorously controlling investment and operational risks. It has been the foundation for the way we've managed money for over 30 years and we believed it has served our clients very well.

BGI's clients are "institutional", by which we mean defined benefit and defined contribution pension plans sponsored by corporations or public agencies, and endowments, foundations and other similar pools of capital. BGI's services to its clients are completely focused on investment management: we do not provide other

[1] BGI includes Barclays Global Investors, N.A., and its worldwide asset management affiliates.

services, such as recordkeeping. Among those institutions we have been honored to serve is the Federal Thrift Savings Plan (TSP). BGI was appointed as the first external manager for the TSP in 1988, and we have successfully retained and grown this relationship in regular, highly competitive bidding processes since that time.

Elements of Disclosure Regime for Plan Sponsors

Plan sponsors need adequate information about investment options (and the fees and expenses associated with them) so that the plan sponsor can exercise its fiduciary responsibility to choose which investment options should be available under the plan. Plan sponsors also have the fiduciary obligation to choose other plan service providers and to understand the cost of those services. Today, the information the plan sponsor needs is sometimes difficult to obtain or difficult to compare. There are two reasons for this. First, there are different investment vehicles (mutual funds, insurance products, bank collective trusts, separate accounts) which have different structures, different compensation mechanisms and different terminology for what may be the same service. Second, it can be more difficult to evaluate fees and expenses when fees for investment management are bundled with fees for administrative and related services.

It is not enough for plan sponsors to understand what fees and expenses are explicitly deducted from a participant's account or paid directly from plan assets or by the plan sponsor from its own funds. To fully evaluate potential investment options and service providers, and their appropriateness for its plan, plan sponsors must understand how each service provider is compensated, both directly and indirectly. BGI supports legislative efforts to require service providers to provide specific disclosures, by fee category, so as to make plan sponsor's decision making less burdensome.

Defined contribution plan service arrangements generally fall into two principal categories. The arrangements may be "bundled", that is, record keeping combined with asset management services or "unbundled", where the plan sponsor selects its investment options separately from its record keeper and other service providers. In some cases, bundled providers limit investment choices solely to their proprietary

investment offerings, and in other cases there is the ability for the plan sponsor to choose investment options outside of the record keepers proprietary funds.

Bundled service arrangements may be appropriate for some plans, particularly smaller ones. This is only appropriate if the fee components of both recordkeeping and asset management are separately and clearly disclosed. Clear, comparable and fully disclosed information about these charges will allow the plan sponsor to more easily and adequately meet its fiduciary responsibility under ERISA to determine that the fees and expenses are reasonable.

We have observed practices by some bundled service providers to provide "free" (or extremely low cost) services, provided the plan sponsor elects to place specified proprietary investment options in its plan. Participants who invest in the options stipulated by the recordkeeper may in this instance be subsidizing recordkeeping for participants who choose other plan investment choices. We believe that recordkeeping and similar administrative charges should be disclosed separately from investment management fees so the plan sponsor may evaluate each of the services independently. It is worth noting that in our experience in the defined benefit market, asset management services and administrative services, such as trustee services, are generally disclosed separately.

We support the bill's conflict of interest disclosure requirements, and urge that this provision be clarified to assure that plan sponsors receive information that is specific to the plan sponsor and the particular service provider. Many of the benefits of disclosure will be lost if generic boilerplate language is sufficient to be compliant. Further, conflicts disclosure should also involve disclosure of potential revenue that the service provider may receive from its 'cross-sell' activities (IRA rollovers, brokerage or insurance) with plan participants. Record keepers and potentially other service providers have unique access to information about individual plan participants—especially their termination or retirement date--and sometimes use this access to market other financial services to these individuals. For example, record keepers may suggest that retiring employees use their affiliates to roll their 401(k) balances into IRAs managed by another affiliate.

Elements of a Disclosure Regime for Plan Participants

The goal of any disclosure framework should be to provide relevant information in a cost effective manner to enable the best possible decisions. The information which plan participants need when choosing an appropriate investment from amongst those investment options selected by their employer differs from that which plan sponsors need to use to determine which investment options to offer (and which service providers to retain).

The most fundamental decisions that plan participants need to make are whether, and at what level, to participate in the plan; which investment options to choose; whether and when to change their investment allocations; and when to take distributions from the plan. These decisions are critical to the future value of the account. Participants' decision making is influenced by many considerations including basic behavioral finance factors.

The bill requires plan sponsors/administrators to individually list every service fee assessed against the participant's account. We agree that participants should be informed about these fees and expenses, and provided information about the impact of these charges on their choice of investment. We believe, however, that the average participant might be better served with a summary of these charges, grouped into categories, with the additional detail available upon request or on the plan's website. These categories would be recordkeeping and similar administrative expenses and asset management fees, and if necessary a third category for any other fees or expenses assessed against their account.[2] Behavioral finance research shows that when confronted with too much information, or information that is not organized to be customer friendly, participants fail to participate or engage in decisions about their investment allocation.

Participant disclosures should provide a consistent, comparable measure of fee and expense information, and should allow plan participants to easily understand

[2] Participant activity generated charges, such as loan fees, would be disclosed in annual statements or the summary plan description and if incurred, reflected in the participant's periodic statement.

investment performance after all fees and expenses paid by the participant, regardless of whether the fees and expenses are asset-based or per participant. In addition, again in a comparable format, these disclosures should include the investment objective and strategy, key investment risks and historical performance for each investment option.

While mutual fund prospectuses, whether standard or in simplified form, may be appropriate for retail investors who are choosing among a vast array of investment alternatives, the amount of information presented in such documents is likely to overwhelm and confuse plan participants. Further, the typical mutual fund prospectus does not contain all the fees and expenses which are charged to a participant's account and for this reason should not be the standard used for disclosure. We support the adoption by the Department of Labor of standardized "fund fact sheets" as the form of disclosure for plan participants. Standardization provides benefits for all: service providers will have clarity on what information, and in what form, they must provide to all of their clients; plan sponsors will have confidence that the disclosures are adequate and not subject to challenge; and employees, who are increasingly mobile, will be able to make more effective comparisons and gain from increasing familiarity with the information when they change employers.

There are a broad variety of investment types that can be offered to plan participants in 401(k) plans. These can be mutual funds, separately managed accounts, bank collective trusts, employer stock, stable value funds, annuities or other insurance products. For a variety of reasons, this broad range of investment types are subject to a variety of regulatory regimes. We know of no regulatory impediment, however, to providing comparable disclosure to participants across all such investment types, regardless of legal structure. In this regard it would be extremely helpful for the Securities and Exchange Commission to confirm that for registered investment options, such as mutual funds, that fund fact sheets are not prospectuses as that term is defined under the federal securities laws.[3] This will assist the industry to reach consensus on a standard, simplified disclosure format across all investment types.

[3] See Section 2 (a) (10) of the Securities Act of 1933, 15 U.S.C. 77b (a) (10).

While transparency as to fees and expenses is important for plan participants, any disclosure document also needs to present this information in context, as too much focus on fees and expenses could promote a tendency among participants to opt for the lowest cost option, (most likely to be a money market fund or company stock) to the detriment of their retirement income. Failure to adequately diversify investments is one of the more common errors made by plan participants.

A number of plans provide multiple investment options within the same general strategy (for example, several large cap domestic equity funds). When a plan does so, behavioral finance research suggests that plan participants would also benefit if the alternatives within the same strategy were either ranked by cost or the least cost alternative were highlighted in someway.

The bill also proposes that all DC plans provide an investment option that is a market-based index fund meeting certain criteria and as prescribed by the Department of Labor. While we believe one of the advantages of ERISA is that it permits plan fiduciaries to make their own prudent decisions about what investments are appropriate for their beneficiaries, the Committee may wish to consider the approach taken by the Federal Employee Retirement Security Act of 1986 (FERSA) which established the Federal Thrift Savings Plan. As amended, FERSA includes six categories of investment options, with a focus on index strategies across the investment spectrum (equity and fixed income) as well as lifecycle funds. While many plan sponsors do provide passive investment options in their plans, this Committee should consider how to further encourage this trend.

Conclusion

Achieving financial security in retirement is a significant challenge for most Americans. Currently, many DC plans have challenges with all three of the major components: the contribution, or savings, component; the investment performance component; and the retirement distribution component. By promoting such features as auto-enrollment and automatic contribution escalation, the Pension Protection Act of 2006 has already focused on the first challenge. By promoting more effective disclosure of fees and expenses to plan sponsors and plan participants, the *401(k) Fair Disclosure for Retirement Security Act of 2007* would improve the second component.

Transparency can be an important catalyst for making DC plans perform more like DB plans in the balance of costs and investment performance and thereby improving the future income of all retirees.

Chairman MILLER. Thank you.
Mr. Thomasson?

STATEMENT OF TOMMY THOMASSON, PRESIDENT–CEO, DAILY ACCESS CORP., CHAIR, COUNCIL OF INDEPENDENT 401(K) RECORDKEEPERS

Mr. THOMASSON. Thank you, Mr. Chairman, Ranking Member McKeon and members of the committee. My name is Tommy Thomasson, and I am the CEO of Daily Access Corporation in Mobile, Alabama. My firm is a leading provider of retirement plan services to small businesses throughout the country.

I currently serve as the chair of the Council of Independent 401(k) Recordkeepers, or CIKR. The members of CIKR provide services for over 70,000 retirement plans covering three million participants, with approximately $130 billion in retirement assets. CIKR is a subsidiary of the American Society of Pension Professionals and Actuaries, which has thousands of members nationwide. As independent service providers, we support and actively practice full fee disclosure.

I want to thank Chairman Miller for his leadership in shining the light on 401(k) fees. We believe this bill would help American workers increase their retirement savings.

The 401(k) plan industry delivers investments and services to plan sponsors and their participants using two primary business models, commonly known as bundled and unbundled. Generally, bundled providers are large financial service companies whose primary business is selling investments. They bundle their proprietary investment products with affiliate-provided plan services into a package that is sold to plan sponsors.

By contrast, unbundled or independent providers are primarily in the business of offering retirement plan services. They will couple such services with a universe of unaffiliated, nonproprietary investment alternatives. The business model of the provider determines the approach to selling and charging for plan services, although the scope of plan services under either model is relatively the same.

Plan fiduciaries must follow prudent practices and procedures when they are evaluating service providers and investment options. This prudent evaluation should include an apples-to-apples comparison of services provided and the costs associated with those services. The only way to determine whether a fee for a service is reasonable is to compare it to a competitor's fee for that service.

It is important to recognize that employees are totally dependent upon the employer's decision-making process and have to manage their retirement assets based upon the plan that has been chosen for them. If the fees are unnecessarily high, the worker will ultimately pay the price. That is why the disclosure made to plan fiduciaries is so critically important.

The Department of Labor has proposed rules that would require enhanced disclosures on unbundled or independent service providers, while exempting the bundled providers from doing so. While we applaud the DOL's interest in addressing fee disclosure, we do not believe that any exemption for a specific business model is in the best interest of plan sponsors and their participants.

Without uniform fee disclosure, fiduciaries will have to choose between a single-price business model and a fully disclosed business model that will not permit them to appropriately evaluate competing provider services and fees. Knowing only the total cost will not allow fiduciaries, particularly less sophisticated small business owners, to evaluate whether certain plan services are sensible and reasonably priced.

In addition, if a reasonable breakdown of fees is not disclosed initially and over time, fiduciaries will not be able to evaluate cost for services as participant account balances grow. Take a $1 million plan serviced by a bundled provider that is only required to disclose a total fee of 125 basis points, or $12,500. If that plan grows

to $2 million in assets, the fee doubles to $25,000, although the level of plan services and the costs of providing such services has generally remained the same.

The bundled providers want an exemption, while demanding that unbundled providers be forced to adhere to disclosure rules and regulations. Simply put, they want to be able to tell plan sponsors that they can offer retirement plan services for free, while independents are required to disclose the fees for the same services.

Of course, there is no free lunch and there are no free services provided in the 401(k) market. In reality, the costs of these free plan services are being shifted to participants, in many cases without their knowledge. The uniform disclosure of fees is the only way that fiduciaries can effectively evaluate the retirement plan they will offer to their workers. To show it can be done, attached to my written testimony is a sample of how uniform plan fiduciary disclosure would look. By breaking down plan fees in only three simple categories—investment management, recordkeeping and administration, and selling costs and advisory fees—we believe plan fiduciaries will have the information they need to satisfy their ERISA duties.

The retirement system in our country is the best in the world when competition is fostered in innovations in investments and service delivery. However, the spirit of Chairman Miller's bill recognizes that important changes are needed to ensure that the retirement system in America remains robust and effective into the future. By enabling fair competition and supporting plan fiduciaries through uniformity of disclosure of fees and services, American workers will have a better chance of building retirement assets and living the American dream.

Thank you, and I welcome your questions.

[The statement of Mr. Thomasson follows:]

Prepared Statement of Tommy Thomasson, President/CEO of DailyAccess Corp., on behalf of ASPPA and CIKR

Chairman Miller, Ranking Member McKeon, and distinguished members of the Committee, my name is Tommy Thomasson, President/CEO of DailyAccess Corporation. My company, based in Mobile, Alabama, provides retirement plan recordkeeping and administration services to thousands of small and medium-sized 401(k) plans throughout the country. I am here today on behalf of the American Society of Pension Professionals & Actuaries (ASPPA) and the Council of Independent 401(k) Recordkeepers (CIKR), for which I currently serve as Chair, to testify on important issues relating to 401(k) plan fee disclosures addressed in Chairman Miller's legislation, the "401(k) Fair Disclosure for Retirement Security Act of 2007" (H.R. 3185).

ASPPA is a national organization of more than 6,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, administrators, actuaries, accountants and attorneys. ASPPA's large and broad-based membership gives ASPPA unusual insight into current practical problems with ERISA and qualified retirement plans, with a particular focus on the issues faced by small to medium-sized employers. ASPPA's membership is diverse, but united by a common dedication to the private retirement plan system.

CIKR is a national organization of 401(k) plan service providers. CIKR members are unique in that they are primarily in the business of providing retirement plan services as compared to larger financial services companies that are primarily in the business of selling investments and investment products. As a consequence, the independent members of CIKR, many of whom are small businesses, make available to plan sponsors and participants a wide variety of investment alternatives from

various financial services companies without bias or inherent conflicts of interest. By focusing their businesses on efficient retirement plan operations and innovative plan sponsor and participant services, CIKR members are a significant and important segment of the retirement plan service provider marketplace. Collectively, the members of CIKR provide services to approximately 70,000 plans covering three million participants holding in excess of $130 billion in assets.

ASPPA and CIKR applaud Chairman Miller's leadership and strongly support his efforts to improve the transparency of 401(k) fee and expense information at both the plan fiduciary and plan participant levels. ASPPA and CIKR share Chairman Miller's concern about making sure plans and plan participants have the information they need—in a form that is both uniform and useful—to make informed decisions about how to invest their retirement savings plan contributions. This information is critical to millions of Americans' ability to invest in a way that will maximize their retirement savings so that they can achieve adequate retirement security.

While both 401(k) plan fiduciaries and participants need clear and consistent information to assess the reasonableness of fees charged for various plan services, the degree of detail that could be required in these disclosures could differ significantly. My testimony will discuss ASPPA's and CIKR's views on the need for uniform disclosure requirements from service providers to plan fiduciaries, regardless of how plan services are delivered, along with our suggested simplifications to the new plan service provider disclosure requirements in H.R. 3185. We will follow this up with our views on the need for sensible and understandable 401(k) plan participant disclosures, along with our suggested modifications to the participant disclosure requirements in H.R. 3185.

Need for Uniform Disclosure to Plan Fiduciaries

Overview of the 401(k) Plan Marketplace

There are currently no rules governing the disclosure of fees charged by plan service providers, and thus disclosure is generally inconsistent and too often nonexistent. ASPPA and CIKR generally support requiring plan service providers to disclose fees that will be charged to assist plan fiduciaries in fulfilling their responsibility to assess the reasonableness of such fees. Such a requirement is included in H.R. 3185. Specifically, the disclosure to plan fiduciaries in H.R. 3185 would require a description of the plan services to be provided, the expected costs of various categories of services, the identity of the service provider and potential conflicts of interest.

ASPPA and CIKR strongly believe that any disclosures required of service provider fees to a plan fiduciary must be provided in a uniform manner, regardless of how plan services are delivered. There are generally two main methods for delivering retirement plan services—"bundled" and "unbundled."

- Bundled providers are primarily in the business of selling investments and package their own proprietary investments with recordkeeping, administration and other retirement plan services. They typically are large financial services companies like mutual funds and insurers.
- Unbundled providers are primarily in the business of providing retirement plan operations and services and will offer such services along with a menu of independent, unaffiliated investment options, often referred to as an "open architecture" platform of investments. Although there are some larger unbundled providers, the vast majority of them are smaller businesses serving the unique needs of their small business clients.

Although they use very different business models, both bundled and unbundled providers deliver the same kind of plan services to plan sponsors and participants.

Bundled and unbundled providers, however, do collect their fees in different ways. In general, a bundled provider collects its fees from plan assets. In the case of a mutual fund, for example, that would be in the form of the "expense ratio" assessed against the particular investment options chosen by participants, reducing their rate of return for the year.[1] In the case of an insurance company, the fee can also be in the form of a percentage fee assessed against total plan assets referred to in the industry as a "wrap fee." In either case, fees collected by bundled providers are generally always charged against participants' accounts. Because the plan sponsor is not paying a fee for services directly to the service provider, bundled providers will present the plan to the plan sponsor as having "free" recordkeeping and administration. There is currently little to no disclosure of this to either plan sponsors or plan participants. There are literally tens of thousands of 401(k) plans that report zero costs for recordkeeping and administration on their annual report (Form 5500) filed with the Department of Labor. In actuality, participant accounts are being charged for these "free" plan services in the form of investment fees assessed against their accounts.

Unbundled providers, by contrast, generally collect fees for the services they provide in two ways—revenue sharing from the company providing the plan's investment options and by a direct charge to the plan and/or plan sponsor, depending on the willingness of the plan sponsor to bear such costs. A portion of the expense ratios for the plan's investment options includes a component for recordkeeping and administration.[2] Since an unbundled provider, not an investment company, is performing recordkeeping and administration, the investment company will typically pass on a portion of the expense ratio to the unbundled provider to compensate them for performing such services. This is commonly known in the industry as revenue sharing. Depending on the size of the plan and the willingness of the plan sponsor to pay directly for retirement plan services, the amount of revenue sharing may be used to offset what would otherwise be charged directly to the plan and/or plan sponsor for recordkeeping and administration. Since the unbundled provider usually receives revenue sharing from an investment company on an omnibus basis (for all plans serviced by the provider but not on a per plan basis), the unbundled provider must employ a reasonable method, usually based on plan assets, for allocating the revenue sharing it receives to each plan for which it provides services.

Complete and Uniform Disclosure is Necessary to Determine "Reasonableness" of Fees

A central point of contention is the position the Department of Labor (DOL) took in proposed Form 5500 regulations, which would exempt bundled service providers from certain fee disclosure requirements applicable to unbundled/independent service providers. Specifically, in the proposed 2008 Form 5500, payments received by service providers from third parties (even though not from plan assets) would need to be disclosed. So, for example, allocable revenue sharing payments received by a third party administrator (TPA) for recordkeeping and administration in connection with the plan would need to be disclosed on the form. However, the regulation would exempt bundled providers from this disclosure requirement, with the result being that bundled providers would not have to disclose comparable internal revenue sharing payments to the affiliated entity or division providing recordkeeping and administration services.[3]

To satisfy their ERISA-imposed fiduciary duty, plan fiduciaries must determine that the fees charged for recordkeeping, administration and other plan services are "reasonable," requiring a comparison to fees charged by other providers, both bundled and unbundled. Inconsistent disclosure requirements between bundled versus unbundled providers will lead to a distorted analysis by plan fiduciaries as they review 401(k) plan fees. For instance, it will be virtually impossible for plan fiduciaries to determine the true costs for plan services provided through a bundled arrangement, which, as noted earlier, are often presented as having no cost. Uniform fee disclosures are needed for plan fiduciaries to make an "apples to apples" comparison of fees for various plan services offered by competing providers.

A breakdown of fees for various plan services will also allow plan fiduciaries to evaluate whether all the various plan services are really needed. The fee assessed by a bundled provider is akin to a "prix fixe" menu at a restaurant. There is only one price for the package and usually no choice about which services are included. Without any reasonable segregation of the costs for plan services, less sophisticated plan fiduciaries, such as small business owners, may not appreciate the fact that the bundled package includes services they may not want or need yet—services they may be paying for under a single "bundled" price arrangement. With this information, plan fiduciaries will be in the position to question the necessity and cost of some of the services, potentially leading to lower costs to the plan and participants.

Plan fiduciaries also need a reasonable breakdown of fees for various services so they can continue to monitor the reasonableness of fees as a plan grows and costs increase. For example, assume a plan with assets valued at $1 million being service by a bundled provider for an "all-in" price of 125 basis points or $12,500. If, through growth of the company and increases in the market value of assets, plan assets grew to $2 million, the fee would be $25,000. However, without any reasonable allocation of fees to services, such as recordkeeping and administration, the plan fiduciary will not be in a position to ask why the fee has doubled even though the level of services has remained essentially the same.

As provided for in H.R. 3185, disclosure of conflicts of interest is also critical. It should not be presumed that plan fiduciaries and participants, particularly those at small businesses, recognize and understand inherent conflicts of interest and their potential impact. A bundled provider will naturally prefer to sell a packaged 401(k) plan with only its own proprietary investments, as opposed to one with investments provided by other financial services companies, since in the former case it will retain all the fees.

Exempting bundled providers from 401(k) plan fee disclosure rules will also greatly interfere with an extremely competitive 401(k) plan marketplace. Enhanced transparency requirements that only apply to unbundled arrangements may make them appear to have higher fees even though the total fees to the plan may in fact be similar, or perhaps even less. Similarly, a provider that has the ability to offer both proprietary investments and investments managed by unrelated investment managers will have an even greater advantage marketing its proprietary investments, because the cost of an arrangement of primarily proprietary investments will appear to be lower than that of an arrangement comprised of primarily independent investments. Small business plan sponsors with less sophistication will be more susceptible to these misperceptions in fee disclosure. Not only does this have the potential for creating a competitive imbalance in the service provider marketplace; even worse, it sets up the possibility that small business plan sponsors will lose an opportunity to choose a plan that will better serve their workers' retirement planning needs.

The bundled providers specifically argue against being subject to a uniform set of disclosure requirements by stating that it would be too expensive to break down the internal or affiliate-provided service costs. They further suggest that any such breakdown would be inherently artificial since any internal cost allocations are merely for budgeting and accounting purposes. The bundled providers also argue that any conflicts of interest between a service provider and its affiliates should be readily apparent to the plan fiduciary.

ASPPA and CIKR respectfully disagree with the position of the bundled providers. We believe it is possible with very little cost to develop an allocation methodology to provide a reasonable breakdown of fees for plan services. We discuss in more detail below how such a simplified breakdown of plan fees could be presented to plan fiduciaries. We note that it is the position of the bundled providers that unbundled providers, their competitors, should disclose such a breakdown of fees along with their allocation methodology, while they should be exempt.[4] As noted earlier, since unbundled providers received revenue sharing on an omnibus basis, not on a per plan basis, such an allocation will be necessary and we believe can be reasonably accomplished.[5] We find it ironic that the bundled providers, all large financial institutions, suggest that unbundled providers, mostly small businesses, be required to do something that they apparently are incapable of doing. Fundamentally, we believe the position of the bundled providers is an attempt to get a competitive advantage through law and/or regulation. Simply put, they want to be able to tell plan sponsors that they can offer retirement plan services for free while unbundled providers are required to disclose the fees for the same services.

The disclosure requirements in H.R. 3185 uniformly apply to all service providers, and ASPPA and CIKR strongly support H.R. 3185 in this respect. The breakdown of fees required in the Miller bill will allow plan fiduciaries to assess the reasonableness of fees by comparison to other providers and will also allow fiduciaries to determine whether certain services are needed, leading to potentially even lower fees.

It is also worthy of note that bundled service providers do provide a breakdown of fees for various plan services to their larger plan clients—clients who have the negotiating power to ask for this detailed cost information. Less sophisticated small businesses without access to this information will not appreciate the conflicts of interest and will be steered toward "prix fixe" packages that include services that they may not need to pay for. Uniform and consistent disclosure, regardless of how plan services are delivered, is necessary to ensure a level playing field and an efficient marketplace, ultimately leading to more competitive fees benefiting both plan sponsors and participants.

Plan Fiduciary Disclosure Proposal

H.R. 3185 would add new ERISA §111(a) to require an annual disclosure from service providers of all fees and conflicts of interest to employers sponsoring 401(k) plans. Plan fiduciaries would not be allowed to enter into a contract with a service provider unless the service provider provides a written annual statement identifying who will be performing services for the plan, a description of each service and the expected annual costs of each service, including any amounts to be paid to affiliated or other third party service providers under the contract. In other words, the rules of disclosure would be the same regardless of whether the services are provided on a "bundled" or "unbundled" basis.

ASPPA and CIKR strongly support the goals of H.R. 3185, and particularly applaud the bill's even, equitable application of its disclosure rules to all plan service providers, regardless of their business structure (i.e., whether bundled or unbundled). The bill's requirement that service providers disclose to plan sponsors all direct and indirect charges against participants' accounts will ensure a level

playing field in an extremely competitive marketplace. That is good news for plan participants' retirement asset accumulation needs and goals.

However, we recommend that the disclosure requirements be clarified to provide a more simplified service provider fee disclosure that will break down the fees for all services under the following components: (1) Investment Management Expenses; (2) Administrative and Recordkeeping Fees; and (3) Selling Costs and Advisory Fees. All fees charged to 401(k) plans can be allocated to one of these components, and we would suggest that any further breakdown would be unnecessarily confusing to plan fiduciaries. These component expenses would be disclosed under three categories based on how they are collected—as fees on investments, fees on total plan assets and fees paid directly by the plan sponsor. We would also support the H.R. 3185 requirement that there be a conflicts of interest statement disclosing any conflicts. To demonstrate that a simplified disclosure form can be accomplished, we have attached to this testimony a sample form for the Committee to review and consider.

Need for Sensible and Understandable Disclosure to Plan Participants

Overview

The level of detail in the information needed by 401(k) plan participants differs considerably than that needed by plan fiduciaries. Plan participants need clear and complete information on the investment choices available to them through their 401(k) plan, and other factors that will affect their account balance. In particular, participants who self-direct their 401(k) investments must be able to view and understand the investment performance and fee information charged directly to their 401(k) accounts in order to evaluate the investments offered by the plan and decide whether they want to engage in certain plan transactions.

The disclosure of investment fee information is particularly important because of the significant impact these fees have on the adequacy of the participant's retirement savings. In general, investment management fees (which can include investment-specific wrap fees, redemption fees and redemption charges) constitute the majority of fees charged to 401(k) participants' accounts and therefore have a significant impact on a participant's retirement security.[6] For example, over a 25-year period, a participant paying only 0.5% per year in plan expenses will net an additional 28% in retirement plan income over a participant in a similar plan bearing 1.5% in participant plan expenses per year. ASPPA and CIKR strongly support a requirement that plan sponsors disclose to plan participants, in a uniform, readily understandable format, all the information that the participant needs to make an informed choice among the investment options offered to them.

There are currently no uniform rules on how this information is disclosed to plan participants by the various service providers. As stated in GAO Report 07-21, this is in large part due to the fact that ERISA requires limited disclosure by plan sponsors and does not require disclosure in a uniform way, which does not foster an easy comparison of investment options. Furthermore, the various types of investments offered in a 401(k) plan (e.g., mutual funds, annuities, brokerage windows, pooled separate accounts, collective trusts, etc.) are directly regulated by separate Federal and State agencies and are not likely to have uniform disclosure rules anytime soon.

401(k) plan participants—as lay investors—generally do not have easy access to fee and expense information about their 401(k) investment options outside of the information that is provided by their plan sponsor and service provider. Further, while the existence of disclosure materials is a significant issue, accessibility and clarity of disclosure are equally compelling concerns. If the information is buried within page upon page of technical language, it is effectively unavailable to participants. If it is provided in an obvious manner, but the structure of the information is such that a participant cannot understand it or compare it to similar information for an alternate investment, it is also effectively unavailable. Therefore, insufficient or overly complicated information will often result in delayed or permanently deferred enrollment, investment inertia and irrational allocations.

It is all too easy to overwhelm plan participants with details they simply do not need, and in many cases do not want. And an overwhelmed participant is more likely to simply ignore all the basic and necessary information that he or she does need to make a wise investment decision, or worse, to simply decline to participate in the plan. Thus, it is critical that the amount and format of information required to be disclosed to plan participants be well balanced to include all the information participants need, but no more than the information they need. To do otherwise risks putting participants in a position of simply declining to participate in the retirement plan, or making arbitrary—and potentially adverse—allocations of their retirement contributions.

Further, there is a cost to any disclosure. And that cost is most often borne by the plan participants themselves. To incur costs of disclosure of information that will not be relevant to most participants will unnecessarily depress the participants' ability to accumulate retirement savings within their 401(k) plans. Thus, appropriate disclosure must be cost-effective, too. The result of mandatory disclosure should be the provision of all the information the plan participant needs, and no more. To require otherwise would unjustifiably, through increased costs, reduce participants' retirement savings. Those participants who want to delve further into the mechanics and mathematics of the fees associated with their investment choices and other potential account fees should have the absolute right to request additional information—it should be readily available on a Web site, or upon participant request. This will take care of those participants who feel they need more detailed information.

Accordingly, ASPPA and CIKR recommend that plan sponsors provide to plan participants upon enrollment and annually thereafter information about direct fees and expenses related to investment options under their 401(k) plan as well as other charges that could be assessed against their account. This mandatory disclosure must be in an understandable format that includes sufficient flexibility to enable various types of potential fees to be disclosed within the context of uniform rules. This simple, uniform, carefully crafted disclosure would allow participants to make more informed decisions regarding their 401(k) accounts by allowing them to simply compare the various fees and expenses charged for each investment option, and by making them aware of the possible other fees they can occur depending on the decisions they make.

To accomplish this objective, ASPPA and CIKR strongly support the requirement in the Miller bill that an exemplary "fee menu" be provided to plan participants upon enrollment, and annually thereafter, that would provide a snapshot of the direct fees and expenses that could potentially be charged against a participant's account (discussed further below). The plan fiduciary would be responsible for ensuring that the fee disclosure document is made available to the participants, but generally would obtain the necessary fee data (and in most cases, the disclosure form itself) from the plan's service provider.

Participant Fee Disclosure Proposal

H.R. 3185 would add new ERISA §§111(b) and (c) to require two separate disclosure requirements to 401(k) plan participants: (1) an advance notice to 401(k) plan participants of investment election information, which would include a plan-level forward-looking "fee menu" that would provide participants at the beginning of the year a summary of all the fees (including investment specific fees, account-based fees and transaction costs) that could be assessed against the account; and (2) an "after-the-fact" participant-specific fee statement that would detail all the various fees assessed against the account of the participant during the past year.

For the reasons below, ASPPA and CIKR fully support the forward-looking "fee menu" participant-specific fee statement. We further support the goal of the "after-the-fact" participant-specific disclosure so that participants will have sufficient information on investment fees so they can assess whether their investment options continue to be appropriate. Given that participants will be receiving a "forward-looking" fee menu setting forth detailed information of any potential fees and expenses for each investment alternative in their plan, we believe that the "after-the-fact" information should be limited to reflect the gross return and net return after fees on each investment alternative available (as discussed below).

Forward-looking "Fee Menu" Notice Requirement

New ERISA §111(b) would require plan administrators to provide an advance notice to plan participants with specific information for each investment option 15 days prior either to the beginning of the plan year and/or any effective date of any material change in investment options. The notice must contain the name of the option, investment objectives, level of risk, historical return and percentage fee assessed against amounts, an explanation of differences between asset-based fees and annual fees and how additional plan-specific information may be obtained.

Along with this notice, ERISA §111(b) would require an annual "fee menu" be provided to participants listing all potential service fees that could be assessed against their account in any given plan year. It is to be written in a manner easily understood by the average participant. The "fee menu" would disclose fees in the following three categories: (1) fees depending on a specific investment option (including expense ratio, participant-specific asset-based fees, possible redemption fees and possible surrender charges); (2) fees assessed as a percentage of total assets; and (3) administrative and transaction-based fees. The fee menu must also include any po-

tential conflicts of interest that may exist with service providers or parties in interest, as determined by DOL.

ASPPA and CIKR support the requirement that an advance, annual notice be provided to participants that would incorporate a forward-looking annual "fee menu," which would provide sufficient information to plan participants to make an informed evaluation of all the potential fees that could affect their accounts. This fee menu requirement is consistent with the recommendations ASPPA and CIKR provided to the DOL on July 20, 2007, in response to their request for information (RFI) regarding fee and expense to disclosures in individual account plans. Attached to this testimony is the sample one-page fee menu submitted to DOL along with our response to the RFI.

"After-the-fact" Notice Requirement of Plan Expenses

New ERISA §111(c) also requires an additional "after-the-fact" participant-specific fee statement that would detail all the various fees assessed against the account of the participant during the past year. The annual participant benefit statement would require a high level of detail to be provided 90 days after the close of each plan.

Specifically, the following specific information would be required: (1) starting balance, vesting status, employer/employee contributions, earnings, fees, ending balance and asset allocation by investment option from the preceding plan year; (2) an extensive list of fees charged against each participant's account for each investment option from the preceding plan year; and (3) historical return and risk level information of each investment option and the estimated amount a participant needs to save each month to retire at age 65.

ASPPA and CIKR support the concept of providing "after-the-fact" information on the investment alternatives so that plan participants can consider the relevant investment return information, along with the effect of fees on each investment, to make a truly informed decision as to whether the options they have selected remain appropriate. Since the proposed fee menu would provide participants with detailed information of any potential fees that could be charged to their accounts, the "after-the-fact" information should be limited to gross return and net return after fees on each investment alternative. Providing information in this manner would reduce costs and provide participants with relevant and understandable information that would allow them to make an informed comparison of each investment option, without overwhelming them with too much detail that they do not need.

Accordingly, ASPPA and CIKR recommend that the "after-the-fact" disclosure be limited to the gross and net return of each investment alternative, to be provided in conjunction with the annual "fee menu" of potential fees for each investment option. We believe these disclosures will provide participants with well-balanced and understandable information to decide on the investments appropriate for them, while helping to ultimately reduce costs for the plan participants who will likely pay for these additional disclosures.

DOL Regulatory Initiatives

It has been suggested by some that Congress should wait until the DOL concludes its currently ongoing regulatory project on new fee disclosure requirements. These initiatives include: (1) a modification to Schedule C of the 2008 Form 5500; (2) guidance on what constitutes "reasonable" compensation under ERISA §408(b)(2) between service providers and plan fiduciaries; and (3) increased disclosure requirements under ERISA §404(c). ASPPA and CIKR believe that while the DOL guidance on this issue is a very important factor in Congress' decision on 401(k) fee disclosure requirements, it is ultimately the right and responsibility of the Congress to make the determination whether more fee disclosure is required, and if so, its appropriate scope and frequency.

Further, the DOL's jurisdiction over fee disclosure issues may be limited to the voluntary ERISA §404(c) plans that are subject to DOL's disclosure rule-making. Arguably, plans that are not operating under the voluntary 404(c) liability protections would also not be subject to DOL's fee disclosure requirements. Guidance applicable only to 404(c) plans would be an unfortunate result that could harm those participants whose employers sponsor non-404(c) plans.

ASPPA and CIKR recommend that the Education and Labor Committee proceed with this inquiry, and with appropriate legislation, regardless of the current status of the DOL regulatory effort. It will not be too late to modify either the legislation or the regulatory guidance if and when either initiative reaches a stage in the process where it would be appropriate to defer one to the other.

Summary

In summary, ASPPA and CIKR applaud this committee, and in particular, Chairman Miller, for his leadership on the important issue of required 401(k) fee/expense disclosure. We support complete and consistent disclosure requirements to both plan fiduciaries and plan participants. We believe that any new disclosure requirements to plan fiduciaries should apply uniformly to all service providers, regardless of the form of their business structure (i.e., "bundled" or "unbundled"). Respecting plan participant disclosures, ASPPA and CIKR fully support a forward-looking annual "fee menu" being provided annually to plan participants in a simple, concise format so that they can make an informed evaluation of all the potential fees that could affect their accounts. Both of these disclosure requirements are included in H.R. 3185, and we commend Chairman Miller for his insight and efforts into these issues.

Again, thank you for this opportunity to testify on these important issues. ASPPA and CIKR pledge to you our full support in creating the best possible fee disclosure rules. I will be happy to answer any questions you may have.

ENDNOTES

[1] A mutual fund prospectus provides more detail of what is contained in an expense ratio, which includes the cost for recordkeeping as well as promotional costs (i.e., Rule 12b-1 fees).

[2] As discussed earlier, this will be explained in more detail in the investment prospectus.

[3] DOL will also soon propose regulations under ERISA §408(b)(2) to resume the requirement of retirement plan service providers to disclose expected fees to plan fiduciaries at "point of sale." It is expected that the rules will be comparable to the disclosures required in the Form 5500 when finalized.

[4] See Testimony of Mary Podesta on behalf of the Investment Company Institute before the ERISA Advisory Council Working Group on Fiduciary Responsibilities and Revenue Sharing Practices (Sept. 20, 2007).

[5] An allocation on the basis of the value of plan assets is one possible allocation method.

[6] GAO Report 07-21 cited a 2005 industry survey estimating that investment fees made up about 80 to 99 percent of plan fees, depending on the number of participants in the plan.

Chairman MILLER. Thank you very much.

Mr. Minsky?

STATEMENT OF LEW MINSKY, SENIOR ATTORNEY, FLORIDA POWER AND LIGHT CO.

Mr. MINSKY. Thank you, Mr. Chairman.

I would like to make several points today. First, the vast majority of 401(k) participants pay substantially lower fees than they would pay as individual retail investors.

Second, we believe that legislative action should be deferred until the Department of Labor promulgates its new rules so that Congress can assess the impact of fee disclosure regulations.

Third, we are concerned that H.R. 3185 goes too far. Compliance costs and litigation threats will increase as a result of added complexity and new requirements, most of which are not necessary to enhance the ability of plan participants to make sound investment choices or to enhance the ability of plan sponsors to select the best service provider.

Recent studies of defined contribution plans have found that total plan costs average between 6 and 159 basis points, depending largely on plan size, participant account balances, asset mix, the type of investments, and the level of services being provided. While we feel that fee costs overall are reasonable, we all agree that continuing improvement is both obtainable and desirable.

I want to take a moment to explain our desire that Congress wait for the DOL to complete its work before proceeding. Major substantive changes in fee disclosure to both plan sponsors and plan participants are expected to result from the DOL fee initiatives. We believe that the regulatory process of soliciting input and

issuing proposed rules and final rules based on comments from all affected parties will result in a more responsive rule and will avoid unintended consequences.

Moreover, regulatory guidance is dynamic. It can be clarified and amended to adapt to changing conditions. Legislation, on the other hand, is cast in stone until changed, and change can be very difficult to enact for reasons often totally unrelated to the core issues. One need look no further than the uncertain future of the technical changes to last year's Pension Protection Act for clarification and confirmation of this point.

The bill creates a new set of complex rules and sanctions regarding service provider disclosures to plan participants. The DOL's expected approach, on the other hand, builds upon existing well-established fiduciary and prohibited transaction rules and sanctions. We prefer the DOL's approach.

The bill also requires that information received by the plan sponsor be made available to plan participants. We believe that such disclosure is unlikely to provide information that is meaningful to participants, and we fear that it will be used to spur frivolous litigation that will result in fewer plans ultimately being offered to workers.

This bill requires the unbundling of fees in a bundled service arrangement. Many sponsors, especially small businesses, prefer a bundled arrangement with one overall cost. As long as sponsors are fully informed of the services being provided and the total cost, we believe that they can evaluate whether the overall fees are reasonable without being required to analyze each fee on an itemized basis.

The participant fee disclosures in the bill are unlikely to provide information that is meaningful to them. We believe that plan participants need to know what fees are that impact their decision to participate in the plan and the specific fees associated with their investment allocation decision. Meaningful disclosure should be relatively simple: the aggregate fee that is paid from a participant's account, rather than the components of that fee. To do otherwise will result in a lengthy and confusing disclosure.

The bill requires plans to include a nationally recognized market-based index fund. We strongly believe that the law should not mandate specific investment options. Such a requirement would set a precedent for further mandates regarding the investment of plan assets which is counter to ERISA's focus on a prudent process and would preempt the judgment of plan investment fiduciaries.

In conclusion, we support enhanced fee disclosure. However, H.R. 3185 as presently drafted is flawed in many regards. We strongly believe that the additional flexibility inherent in the regulatory process makes the DOL initiatives the appropriate vehicle for new disclosure requirements. Any new legislative requirements would only delay those efforts, resulting in delayed reforms. If the committee proceeds with H.R. 3185, we recommend a comprehensive rewrite that ensures a more streamlined regime.

We appreciate the opportunity to appear before you today and to testify on this very important matter. Thank you.

[The statement of Mr. Minsky follows:]

Prepared Statement of Lew Minsky, Senior Attorney, Florida Power and Light Co.

Chairman Miller, Ranking Member McKeon, and Members of the Committee, thank you for the opportunity to appear before you today to discuss H.R. 3185, the 401(k) Fair Disclosure for Retirement Security Act of 2007. My name is Lew Minsky and I am a Senior Attorney at Florida Power and Light Company. I am responsible for the legal issues relating to FPL's employee benefit plans and executive compensation arrangements. We currently offer two defined contribution plans covering 15,000 participants. I am testifying today on behalf of The ERISA Industry Committee (ERIC), the Society for Human Resources Management, the National Association of Manufacturers (NAM), The United States Chamber of Commerce, and the Profit Sharing/401k Council of America (PSCA).

ERIC is a nonprofit association committed to the advancement of America's major employer's retirement, health, incentive, and compensation plans. ERIC's members' plans are the benchmarks against which industry, third-party providers, consultants, and policy makers measure the design and effectiveness of other plans. These plans affect millions of Americans and the American economy. ERIC has a strong interest in protecting its members' ability to provide the best employee benefit, incentive, and compensation plans in the most cost effective manor.

The Society for Human Resource Management (SHRM) is the world's largest association devoted to human resource management. The Society serves the needs of HR professionals and advances the interests of the HR profession. Founded in 1948, SHRM has more than 225,000 members in over 125 countries, and more than 575 affiliated chapters.

The NAM is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. The vast majority of NAM members provide 401(k) plans for their employees and thus have a significant interest in this legislation.

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region. The Chamber represents a wide management spectrum by type of business and location. Each major classification of American business—manufacturing, retailing, services, construction, wholesaling, and finance—is represented. Also, the Chamber has substantial membership in all 50 states, as well as 105 American Chambers of Commerce abroad. Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

Established in 1947, PSCA is a national, non-profit association of 1,200 companies and their 6 million plan participants. PSCA represents its members' interests to federal policymakers and offers practical, cost-effective assistance with profit sharing and 401(k) plan design, administration, investment, compliance and communication. PSCA's services are tailored to meet the needs of both large and small companies. Members range in size from Fortune 100 firms to small, entrepreneurial businesses.

Let me begin by saying that we all strongly support concise, effective, and efficient fee disclosure to participants. We support increased transparency between service providers and plan sponsors, and between plan sponsors and participants. We all share strong concerns that H.R. 3185 would sharply increase compliance costs and litigation threats by adding complexity and new requirements well beyond what is necessary to enhance the ability of plan participants to make good investment choices or the ability of plan sponsors to select the best service provider.

The Current System

Numerous aspects of ERISA already safeguard participants' interests and 401(k) assets. Plan assets must be held in a trust that is separate from the employer's assets. The fiduciary of the trust (normally the employer or committee within the employer) must operate the trust for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. In other words, the fiduciary has a duty under ERISA to ensure that any expenses of operating the plan, to the extent they are paid with plan assets, are reasonable.

It is important that as it considers new legislation, Congress fully understand the realities of fees in 401(k) plans. The vast majority of participants in ERISA plans have access to capital markets at lower cost through their plans than the participants could obtain in the retail markets because of economies of scale and the fiduciary's role in selecting investments and monitoring fees. The level of fees paid among all ERISA plan participants will vary considerably, however, based on variables that include plan size (in dollars and/or number of participants), participant

account balances, asset mix, and the types of investments and the level of services being provided. Larger, older plans typically experience the lowest cost.

A study by CEM Benchmarking Inc. of 88 US defined contribution plans with total assets of $512 billion (ranging from $4 million to over $10 billion per plan) and 8.3 million participants (ranging from fewer than 1,000 to over 100,000 per plan) found that total costs ranged from 6 to 154 basis points (bps) or 0.06 to 1.54 percent of plan assets in 2005. Total costs varied with overall plan size. Plans with assets in excess of $10 billion averaged 28 bps while plans between $0.5 billion and $2.0 billion averaged 52 bps. In a separate analysis conducted for PSCA, CEM reported that, in 2005, its private sector corporate plans had total average costs of 33.4 bps and median costs of 29.8 bps.

Other surveys have found similar costs. HR Investment Consultants is a consulting firm providing a wide range of services to employers offering participant-directed retirement plans. It publishes the 401(k) Averages Book that contains plan fee benchmarking data. The 2007 edition of the book reveals that average total plan costs ranged from 159 bps for plans with 25 participants to 107 bps for plans with 5,000 participants. The Committee on the Investment of Employee Benefit Assets (CEIBA), whose more than 115 members manage $1.4 trillion in defined benefit and defined contribution plan assets on behalf of 16 million (defined benefit and defined contribution) plan participants and beneficiaries, found in a 2005 survey of members that plan costs paid by defined contribution plan participants averaged 22 bps.

It is important that before Congress consider any legislation in an effort to enhance disclosure of these fees, that they fully understand the great deal many employees are already enjoying in their 401(k) plans.

Current Regulatory Action on Fees

Fee disclosure and transparency present complex issues. Amending ERISA through legislation to prescribe specific fee disclosure will lock in disclosure standards built around today's practices and could discourage product and service innovation. The Department of Labor (DOL) has announced a series of regulatory initiatives that will make significant improvements to fee disclosure and transparency. We support the DOL's efforts and have been active participants in them. While legislative oversight of DOL's disclosure efforts is appropriate, we believe that this is the best approach to enhance fee transparency in a measured and balanced manner and we urge Congress to delay taking legislative action until the Department has completed its work.

Among DOL's fee disclosure efforts are revised annual reporting requirements for plan sponsors. We expect DOL to release finalized modifications to the Form 5500 and the accompanying Schedule C, on which sponsors report compensation paid to plan service providers, within the next few weeks. The modifications will expand the number of service providers that must be listed and impose new requirements to report service provider revenue-sharing. The final regulations implementing the new Form 5500 are expected to first be applicable to the 2009 plan year.

DOL also intends later this year to issue a revised regulation under ERISA Section 408(b)(2), which is a statutory rule dictating that a plan may pay no more than reasonable compensation to plan service providers. The expected proposal is designed to ensure that plan fiduciaries have access to information about all forms and sources of compensation that service providers receive (including revenue-sharing). Both sponsors and providers will be subject to new legal requirements under these proposed rules, including an anticipated requirement that all third party compensation be disclosed in contracts or other service provider agreements with the plan sponsor.

The DOL's remaining initiative focuses on revamping participant-level disclosure of defined contribution plan fees. DOL issued a Request for Information ("RFI") in April 2007 seeking comment on the current state of fee disclosure, the existing legal requirements, and possible new disclosure rules. Several of us filed individual comments and we all issued a joint response with seven other trade associations. DOL has indicated that it intends to propose new participant disclosure rules early in 2008 that will likely apply to all participant-directed individual account retirement plans.

Principles of Reform

As I said earlier, we do not oppose effective and efficient disclosure efforts. Working together with seven other trade associations, we developed a comprehensive set of principles that should be embodied in any efforts to enhance participant fee disclosure.

• Sponsors and Participants' Information Needs Are Markedly Different. Any new disclosure regime must recognize that plan sponsors (employers) and plan participants (employees) have markedly different disclosure needs.

• Overloading Participants with Unduly Detailed Information Can Be Counterproductive. Overly detailed and voluminous information may impair rather than enhance a participant's decision-making.

• New Disclosure Requirements Will Carry Costs for Participants and So Must Be Fully Justified. Participants will likely bear the costs of any new disclosure requirements so such new requirements must be justified in terms of providing a material benefit to plan participants' participation and investment decisions.

• Information About Fees Must Be Provided Along with Other Information Participants Need to Make Sound Investment Decisions. Participants need to know about fees and other costs associated with investing in the plan, but not in isolation. Fee information should appear in context with other key facts that participants should consider in making sound investment decisions. These facts include each plan investment option's historical performance, relative risks, investment objectives, and the identity of its adviser or manager.

• Disclosure Should Facilitate Comparison But Sponsors Need Flexibility Regarding Format. Disclosure should facilitate comparison among investment options, although employers should retain flexibility as to the appropriate format for workers.

• Participants Should Receive Information at Enrollment and Have Ongoing Access Annually. Participants should receive fee and other key investment option information at enrollment and be notified annually where they can find or how they can request updated information.

We strongly urge that the requirements of H.R. 3185 be measured against these background principles.

H.R. 3185's Service Disclosure Statement

H.R. 3185 would require plan service providers to provide a "service disclosure statement" that describes all plan fees, in twelve specific detailed categories, as a condition of entering into a contract. The proposal would also require that this information be broken down by each cost component or be "unbundled." The statement must describe the nature of any "conflicts of interests," the impact of mutual fund share class if other than "retail" shares are offered and if revenue sharing is used to pay for "free" services.

In general, we are concerned that the bill effectively makes plan sponsors liable for the actions of service providers. Such a structure would create an endless opportunity for litigation as lawyers seek to make plan sponsors guarantors of investment success. This would likely lead some plan sponsors to drop or curtail their plans to avoid the liability created by the bill.

Disclosure Provisions

We also have several concerns with the specific disclosure provisions included in this section of the bill. First, the requirements of H.R. 3185 are duplicative with the existing fiduciary requirement that fees paid with plan assets be reasonable. The DOL's pending proposed regulatory changes under section 408(b)(2) likely will result in similar disclosures, provided at the same general point in time, as this new provision. Under the DOL's approach, the disclosures will be incorporated into fiduciary requirements regarding plan fees, making noncompliance a prohibited transaction.

Second, we believe that the requirement to "unbundled" bundled services and provide individual costs in many detailed categories is not particularly helpful and would lead to information that is not meaningful. It also raises significant concerns as to how a service provider would disclose component costs for services that are not offered outside a bundled contract. Any such unbundling would be subject to a great deal of arbitrariness. The posting of detailed unbundled services information could also force the public disclosure of proprietary information regarding contracts between service providers and plan sponsors. Compliance with this provision will require a substantial expenditure of time and effort to generate numbers that currently do not exist, are at best gross approximations, and are of extremely little practical value. These costs will ultimately be passed on to plan participants through higher administrative fees.

ERISA currently requires plan administrators to ensure that the aggregate price of all services in a bundled arrangement is reasonable at the time the plan contracts for the services and that the aggregate price for those services continues to be reasonable over time. For example, asset-based fees should be monitored as plan assets grow to ensure that fee levels continue to be reasonable for services with relatively fixed costs such as plan administration and per-participant recordkeeping. The plan administrator should be fully informed of all the services included in a bundled ar-

rangement to make this assessment. Many plan administrators, however, may prefer reviewing costs in an aggregate manner and, as long as they are fully informed of the services being provided, they can compare and evaluate whether the overall fees are reasonable without being required to analyze each fee on an itemized basis.

Conflict of Interest Provisions

We also have concerns regarding the "conflicts of interest" provisions. ERISA already prescribes strict rules for prohibited activities for service providers who are parties-in-interest or fiduciaries to a plan. While disclosure of conflicts is important, the provision goes much further by requiring the disclosure of relationships and affiliations between different providers, regardless of whether these relationships involve a conflict of interest. Plan sponsors are expected to be provided with considerably expanded disclosures in the near future as the result of the DOL initiatives (in all likelihood sooner than if new legislation is enacted).

We are concerned that these provisions might be seen as creating a new set of fiduciary obligations on plan administrators and increase the likelihood of litigation. We are concerned that a plan sponsor fiduciary might find itself challenged for retaining a service provider after having a financial or personal relationship disclosed to it because the proposed legislation labeled the relationship as one involving a conflict of interest. It should be clear that this section does not create any new conflict-of-interest definitions and mirrors the prohibited transactions in ERISA.

Share Class Disclosure

The purpose of the share class disclosure requirement is not clear. Depending on the size of a plan and its service needs, participants may pay fees that are lower, higher, or the same as "retail" prices. There are myriad costs associated with administering a 401(k) plan that do not apply to individual ownership of a mutual fund and, for this reason, participants in some plans, particularly new small business plans, may pay additional costs. A comparison with an "institutional" share in this situation could result in an incorrect conclusion that the plan is paying more than reasonable expenses.

Estimates

While we appreciate the attempt to ease the burden of calculating numbers which are not known and in many cases unknowable and/or unobtainable from a practical perspective by allowing for the use of some estimates, this section would create substantial potential liability for plan sponsors. This section's language would result in plan sponsors litigating whether it had "known" such information (the scope of which is very unclear) and whether its estimate of expenses was "reasonable." Additionally litigation could arise regarding whether estimates were "materially incorrect." The substantial risk of litigation would ultimately lead many, especially small and mid-size, plan sponsors to discontinue or substantially curtail their retirement programs—a result that is in no one's best interest.

H.R. 3185's Plan Participant Disclosure

The requirements of H.R. 3185 for participant fee disclosure are numerous, burdensome, complex, and likely to increase participant confusion rather than enhance participant knowledge. Under H.R. 3185, plan administrators must provide an advance notice of investment election information to participants and beneficiaries, generally 15 days prior to the beginning of the plan year. The notice must include the name of the option; investment objectives; risk level; whether the option is a "comprehensive investment designed to achieve long-term retirement security or should be combined with other options in order to achieve such security"; historical return and percentage fee assessment; explanation of differences between asset-based and other annual fees; benchmarking against a nationally recognized market-based index or other benchmark retirement plan investment; and where and how additional plan-specific and generally available investment information regarding the option can be obtained.

The notice must include a statement explaining that investment selection should not be based solely on fees but on other factors such as risk and historical returns. The notice must include a fee menu of the potential service fees that could be assessed against the account in the plan year. Fees must be categorized as, 1) varying by investment option (including expense ratios, investment fees, redemption fees, surrender charges); 2) asset-based fees assessed regardless of investment option selected; and 3) administration and transaction fees, including plan loan fees, that are either automatically deducted each year or result from certain transactions. The fee menu shall include a general description of the purpose of each fee, i.e., investment management, commissions, administration, recordkeeping. The menu will also in-

clude disclosure of potential conflicts of interest that may exist with service providers or parties in interest, as directed by the Secretary of Labor.

Again, we support disclosure of relevant fee information, but flexibility should be provided to ensure that the plan administrator can tailor the disclosure to meet the needs of plan participants. The participant disclosure requirements as presently drafted will likely result in lengthy "legalese" documents that would confuse most participants and possibly hinder rather than help them make investment decisions. The scope and detail of the disclosure might well result in a document that, at best, is ignored and, at worst, deters participation in the plan.

We agree that fee information should not be provided in a vacuum. Doing so would lead some participants to merely select the lowest cost option without regard to whether the risk and return of that option are appropriate for the participant. Some of the required data elements and comparisons in the legislation use confusing terminology, have overlapping requirements, or are excessively detailed. For example, a "benchmark retirement plan investment" does not currently exist and no single benchmark is appropriate for every kind of investment. In many cases the required participant disclosure item would apply to some products and not others, and could be difficult to calculate, especially by the plan administrator.

H.R. 3185's Annual Benefit Statement

H.R. 3185 would also require plan administrators to provide a detailed annual benefits statement that is impractical and costly. It includes starting balance; vesting status; contributions by employer and employee during the plan year; earnings during the plan year; fees assessed in the plan year; ending balance; asset allocation by investment option, including current balance, annual change, net return as an amount and a percentage; service fees charged in the year for each investment, including, separately, investment fees (expense ratios and trading costs), load fees, total asset based fees (including variable annuity charges), mortality and expense charges, guaranteed investment contract (GIC) fees, employer stock fees, directed brokerage charges, administrative fees, participant transaction fees, total fees, and total fees as a percent of current assets; and the annual performance of the investment options selected by the participant as compared to a nationally recognized market based index.

Recordkeeping systems are not currently able to meet all the requirements of the annual benefit statement in H.R. 3185. Additional costs to participants will result from the significant system changes needed to comply and simpler disclosure would provide much of the same benefits to participants. Much of the required data about the plan and the participant's account that can be ascertained by the plan administrator is already required to be disclosed in the new benefit statement mandated under the Pension Protection Act, yet there is no coordination of the two requirements.

H.R. 3185's Index Fund Mandate

H.R. 3185 would mandate that plans include at least one investment option which is a nationally recognized market-based index fund that, as determined by the DOL, offers a combination of historical returns, risks, and fees that is likely to meet retirement income needs at adequate levels of contribution.

We strongly believe that specific investment options should not be mandated by law (with resulting fiduciary liability if the investment is found not to meet statutory and regulatory requirements). The provision would override a plan's ability to select and monitor plan investments by reaching a values conclusion that this investment is appropriate for all plans. It sets a precedent for further mandates regarding the investment of plan assets which is counter to ERISA's focus on a prudent process and would preempt the judgment of investment professionals. It is unlikely that any one "market-based index" alone is "* * * likely to meet retirement income needs." Further, embedding a particular investment option in law may lead participants to believe that this is either the "best" option or the government-sanctioned option, thereby steering plan participants into the investment which may not be appropriate for the individual participant.

H.R. 3185's Effective Date

The effective date of H.R. 3185 is unrealistic. Numerous changes to recordkeeping systems would be required to meet the bill's various provisions. In addition, the bill includes no transition period for plan administrators who currently have contracts with service providers and would seem to endanger to the contractual relationships that exist between those parties.

Conclusion

We support effective fee disclosure. However, H.R. 3185 is flawed in many regards. We strongly believe that the additional flexibility inherent in the regulatory system make DOL a more appropriate place for new disclosure requirements. DOL already has numerous initiatives underway to enhance disclosure between plan sponsors and participants and between plan sponsors and service providers. Any new legislative requirements would likely only slow those efforts resulting in delayed reforms.

Plan sponsors and service providers alike are committed to creating new investment options and administrative techniques to improve retirement security. Automatic enrollment, automatic contribution step-ups, target-date and lifecycle funds, managed accounts are just some of the numerous innovations that have benefited 401(k) participants—indeed some of them may not even have been participants if not for such products—and enhanced their retirement security. Statutory requirements for fee disclosure would freeze disclosure in the present, making enhancements and innovations more difficult in the future.

If the Committee proceeds with H.R. 3185, we recommend a comprehensive rewrite than ensures it comports with the principles we have outlined in our testimony. Any other result could jeopardize the future of the defined contribution system at a time when it is increasingly critical for American workers. We appreciate the opportunity to appear before you today and testify on this very important matter.

Chairman MILLER. Thank you.

Mr. Chambers?

STATEMENT OF JON CHAMBERS, PRINCIPAL, SCHULTZ, COLLINS, LAWSON, AND CHAMBERS, INC.

Mr. CHAMBERS. Chairman Miller, Ranking Member McKeon and distinguished members of the committee, thank you for the opportunity to present my views on 401(k) fee disclosure to this committee.

As an investment consultant to defined contribution plans, I focus a significant portion of my practice on helping plan sponsors and other fiduciaries to quantify and understand the fees incurred in relation to their plans. For our clients, we typically review fee structures once a year. Additionally, we are regularly engaged in managing more formal requests for proposal or RFP processes intended to help plan fiduciaries select a new plan provider or to validate the retention of an existing provider.

Since we examine 401(k) fees for a broad cross-section of plans, we are well positioned to see a variety of fee arrangements. I would like to share some real-world examples from our practice that will highlight how H.R. 3185 would help plan fiduciaries make better decisions.

As the committee has heard, one of the more contentious elements of 401(k) fee structures is revenue sharing, which essentially is the transfer of investment fees to cover administrative costs. I would like to share a few examples about revenue sharing and how it can be used positively or negatively, and how even the largest employers frequently misunderstand it.

Recently, we were engaged by a large 401(k) plan sponsor to help with investment issues related to a fund mapping. This particular plan sponsor hadn't worked with an investment consultant in the past. Fiduciary reviews were conducted by the financial firm that served as the plan recordkeeper, working with the company's own treasury staff.

The company would not have engaged an independent consultant if it hadn't been for these mapping issues. That didn't mean that they didn't provide regular fiduciary reviews of the choices, but they did it working with the financial services firm, rather than with an independent consultant. The company's contract with the financial firm provided for no explicit fee payments. Recordkeeping and compliance services were covered by profit margins on the financial firm's proprietary funds, as well as revenue sharing payments from nonproprietary funds that were offered through the plan.

The plan sponsor thought the plan fees must be reasonable because as they reviewed each investment option, each investment option had reasonable fees. Now, as we worked on the mapping project, we also did a fee reasonableness study. We demonstrated that the total fees being generated by the financial firm were approximately $1 million higher than were necessary in an unbundled arrangement. This company was able to negotiate share class changes with their financial services provider and save plan participants approximately $1 million a year.

I would like to stop and highlight here that one of the important elements of H.R. 3185 is the need to disclose different share class availability. That is something that most plan sponsors wouldn't know about unless they either worked with an independent consultant or there were a requirement that it be disclosed to them.

As an investment consultant, we work with large plans primarily. We don't get an opportunity to work with smaller clients most of the time. They can't afford our services. We believe that H.R. 3185 would bring the type of information that we provide to larger plans to bear for smaller plans.

Third, briefly I would like to talk about an RFP that we manage for a smaller plan, a plan with about $15 million in assets. When we run an RFP, we typically include proposals from both bundled and unbundled service providers. We ask both the bundled and unbundled providers to separately propose fees for administrative and investment management services. This helps the fiduciaries make an informed decision about the cost and quality of each service element.

A recent proposal that we ran for this regional bank solicited five proposals—two from insurance companies, two from mutual fund companies, and one from an unbundled TPA provider. One of the insurance companies refused to propose unbundled services and we neglected to consider their proposal further. Another insurance company said, "Yes, we will unbundle services," and they actually had the highest fees. However, they said zero fees were available if their fixed account were used as an option.

The two fund companies had mostly unbundled arrangements. One fund company had higher management fees and lower direct fees. The other had lower fund fees and higher administrative fees. And finally, the TPA had the lowest overall costs.

Our client chose to go with the relatively low-cost mutual fund company because they had the information to make an informed decision. We believe that H.R. 3185 would provide the opportunity for plan sponsors to get enough information to make informed deci-

sions, thereby driving down total costs of plan administration for all Americans.

Thanks for the opportunity to testify.

[The statement of Mr. Chambers follows:]

Prepared Statement of Jon C. Chambers, Principal With Schultz Collins Lawson Chambers, Inc.

Chairman Miller, Ranking Member McKeon and distinguished members of the Committee, my name is Jon C. Chambers and I am a principal in the San Francisco, California investment consulting firm of Schultz Collins Lawson Chambers, Inc. Since 1995, our firm has provided a broad range of investment consulting services to defined contribution plan sponsors. My client base is primarily comprised of 401(k) plans. I consult to plans sponsored by approximately 30 employers on a recurring basis, and also serve other clients on a one-time project basis. My clients include a mixture of publicly traded and privately held companies, as well as not-for-profit organizations and governmental entities. Prior to joining Schultz Collins Lawson Chambers, Inc., I spent ten years as a retirement plan consultant with the accounting firm Coopers & Lybrand.

As an investment consultant to defined contribution plans, I focus a significant portion of my practice on helping plan sponsors and other fiduciaries to quantify and understand the fees incurred in relation to their plans. For our recurring clients, we typically review fee structures at least once a year. Additionally, we are regularly engaged to manage a more formal Request for Proposal (RFP) process intended to help plan fiduciaries select a new plan provider, or to validate the retention of an existing provider. We generally manage between two and six RFP projects each year, although with the recent heightened attention on 401(k) fees, we have been seeing an increased demand for our RFP services. Since we examine 401(k) fees for a broad cross-section of plans, we are well positioned to see a variety of fee arrangements.

I am actively involved in the retirement plan consulting community. I am a member of the Profit Sharing/401(k) Council of America (PSCA), the American Society of Pension Professionals & Actuaries (ASPPA) and a member and past president of the San Francisco Chapter of the Western Pension & Benefits Conference (WP&BC). However, it's important to note that my testimony today is my own, and is not intended to reflect the views of any of these organizations. Over the past year, I've spoken on 401(k) fees at conferences sponsored by WP&BC and ASPPA. During this period, I have met with officials from the Securities and Exchange Commission (SEC), the Government Accountability Office (GAO) and the Department of Labor's Employee Benefit Security Administration (EBSA) to discuss the issue of improving disclosure of 401(k) fees.

I very much appreciate the opportunity to present my views on 401(k) fee disclosure to this Committee. The issues being discussed are challenging and technical, yet a reasonably successful resolution of the problem would go a long way towards improving the retirement security of millions of Americans. I commend Chairman Miller and this Committee for tackling such an important topic.

Background on the 401(k) Fee Issue

401(k) fees have been a predominant discussion topic in the retirement plan consulting community over the past five years. There are several reasons why 401(k) fees have recently become a critical issue:

- The 2000-2002 stock market plunge reminded 401(k) plan participants that investment returns could be negative, and that fund expenses compound losses. While participants arguably should have been equally sensitive to fund expenses during the bull market of the late 1990s, participants seeing losses in their 401(k) accounts focus greater attention on fees.
- With many companies freezing or terminating their defined benefit plans, 401(k) plans are transitioning from being a supplemental savings vehicle to the primary retirement plan for many Americans.
- Outreach by the Department of Labor has encouraged both plan sponsors and participants to pay greater attention to 401(k) fees.
- Numerous stories in the popular media, including such diverse venues as PBS' Frontline, the Los Angeles Times, and Money magazine have highlighted 401(k) fee issues, with particular attention focused on egregious examples of excessive fees.
- Litigation (seeking class action status) has been filed against many of the largest companies in America, claiming that 401(k) fees were excessive and not properly disclosed.

• Congressional activities, including hearings held by this Committee, have focused national attention on the 401(k) fee issue.
• Following up on results from hearings and an independent study also published in 1997, as well as on recommendations published in 2004 by the ERISA Advisory Council's Working Group on Plan Fees and Reporting on Form 5500, the Department of Labor has announced a series of regulatory initiatives to improve disclosure of 401(k) fees.

Despite all this attention, the way that most 401(k) service providers charge for fees hasn't changed much over the past decade. As this Committee heard in March, more than 90% of 401(k) fees are investment based. Generally, investment based fees are paid by plan participants, and are not typically disclosed to participants, at least not, in my view, in a clear and obvious manner. While speakers at the March 6 hearings disagreed about whether the aggregate level of 401(k) fees was excessive, there was general consensus that at least some fee arrangements are excessive, and that more rigorous and comprehensive disclosure standards are necessary. The debate is not about whether more disclosure is desirable, but rather, it is about what type of disclosure should be made, to whom, in what form, and who should bear the cost of that disclosure. Much of the debate centers around whether new disclosure requirements should be imposed by statute or by regulation.

Statutory Changes are Necessary to Resolve the 401(k) Fee Disclosure Problem

I personally believe that we need a material change in the statutory framework governing how 401(k) plans must disclose fees. To understand why this is so requires a brief review of the legislative history of ERISA, and the development of the modern 401(k) plan. ERISA—the Employee Retirement Income Security Act of 1974—was enacted when defined benefit plans were the nation's predominant retirement plan. The tax code changes permitting 401(k) plans were not enacted until 1978, and 401(k)s weren't broadly adopted and did not enter the mainstream vernacular until the 1980s. ERISA could not have contemplated disclosure rules for 401(k)s because 401(k)s did not exist when ERISA was enacted.

One question that can be asked is if ERISA sets general standards for retirement plans, why should the rules that apply to 401(k)s be any different? There were certainly defined contribution plans operating in the 1970s. Why can't the general ERISA disclosure rules be sufficient for 401(k)s? The answer to this question turns on the unique environment in which the modern 401(k) operates. Today, most 401(k) plans are:

• Participant directed (which means that participants choose their own investment approach from a menu of funds selected, directly or indirectly, by their employer);
• Invested (either directly or indirectly) in mutual funds;
• Valued daily, with daily trading; and
• Administered by financial services firms.

While the typical 401(k) plan's daily valued, participant directed structure provides significant investment flexibility for participants, it also introduces numerous administrative costs. Participants must be educated about the funds on the menu, and how to make rational asset allocation decisions. Call centers and Web sites must be established and maintained to provide participants with information about their accounts, and to permit participants to initiate daily trades. Accounts must be balanced and reconciled daily. And of course, since 401(k) plans operate through payroll deduction, the process of converting salary deferrals into fund purchases on each and every pay date makes 401(k) administration transactionally intensive.

Cost Sharing Arrangements and Employer Conflicts of Interest

Fees for 401(k) plans are generally shared between participants and the employer, with the participants paying investment costs, and the employer paying for the costs of plan administration, to the extent that revenue sharing payments from the plan's investments are not available to offset administrative costs. Various surveys indicate that, on average, more than 90% of 401(k) fees are investment related.

As I mentioned earlier, we manage the RFP process for many 401(k) plans. In our experience, when a mid-sized or larger plan (typically, at least $10 million in total plan assets), with average participant account balances of at least $50,000, sends out an RFP, the most typically quoted price for administrative and compliance services necessary to run the plan is "zero." Of course, the true cost of providing these services is not zero. Investment expenses may have been increased to generate additional revenues, which are then used to cover the costs of the administrative services. But an unsophisticated employer conducting an RFP for 401(k) services that sees a zero fee quote for the administrative component from the majority of the respondents very quickly concludes that zero is the right price for these services. Most

employers don't worry too much about why the explicit fee is zero. They don't realize that their employees must be implicitly paying for plan administration through higher than necessary investment fees. They don't know to ask whether the increased investment fees are more costly to participants than would be the case if the investment and administrative services were engaged separately. They usually choose one of the zero cost fee providers, and move forward.

Unlike the modern employer offering a 401(k) as its primary retirement plan, defined benefit plan sponsors have always had a vested interest in minimizing investment expenses incurred by their plans. Since a defined benefit plan's funding requirements are at least partially determined by the plan's net investment returns, cutting investment expenses has the direct effect of reducing required contributions from the plan sponsor. When ERISA was drafted, employers were presumed to have the same objective as employees—to minimize investment fees, to the extent practical. But under a modern 401(k) plan, an employer has an understandable incentive to select funds with investment fees that are high enough that the employer incurs no administrative costs. Worse yet for the plan participants, under existing ERISA rules, there is no requirement that they receive any disclosure about fees that may be applied to their account. And finally, unless the employer is savvy enough to press the proposing vendor about fee transfers and revenue sharing arrangements, there is no current requirement for fee disclosure from the plan provider to the employer. A federal district court ruling dismissing all claims in one of the recently filed 401(k) excessive fee lawsuits highlighted this point. In support of his decision to dismiss the case, Judge John C. Shabaz notes:

A review of the report [the ERISA Advisory Counsel Report of the Working Group on Plan Fees and Reporting on Form 5500] confirms that the revenue sharing issue raised by plaintiffs' complaint is a matter of policy concern within the Department of Labor. It also unequivocally confirms that present regulations do not require disclosure of the information. See particularly the report's Recommendations for Regulatory Change at p. 8. Whether, as a policy matter, additional reporting of revenue sharing arrangements should be required, it is not presently required and failure to include such information does not violate existing ERISA standards for disclosure. Accordingly, defendants' failure to so disclose is not a violation of the present statute of [sic] regulations and does not state a claim for breach of the duty of disclosure. (emphasis added) Hecker v. Deere & Co., No. 06-C-719-S (W.D.Wis. June 21, 2007)

In my experience, employers aren't actively pushing for a transfer of plan costs from employer to employee, they are simply reacting rationally to how the financial services industry presents plan fees today. Most employers with whom we work seek to pay a fair fee for plan services, without causing their employees to pay excessive fees. But when employers are presented with a range of proposals for 401(k) services, all of which provide for zero explicit fees, they presume that zero fees are standard practice for the industry, without understanding the impact of implicit, fund based fees on their employees. One of the key benefits of H.R. 3185 is that employers would be able to make informed decisions about how plan administrative costs would be shared between plan participants and the employer. Employers that choose to pass through all plan costs to participants would still be permitted to do so, either through implicit revenue sharing payments, or through explicit allocation of hard dollar costs (provided, of course, that such plan costs could properly be charged to the plan under ERISA).

Under current law, employers face potential liability if they do not satisfy their fiduciary duty to ensure that 401(k) plan fees are reasonable. This potential liability has recently been made manifest in very real litigation. However, in many cases, employers lack the information necessary to prudently evaluate fee structures. Furthermore, financial firms regularly price their 401(k) services in a manner that causes employers to focus less on fees paid by participants and more on fees paid (or avoided) by the employer. Larger employers have the financial resources and perspective necessary to engage consulting firms such as ours to help them make reasonable and prudent fiduciary decisions. While I believe that employers should continue to play a fiduciary oversight role with respect to their retirement programs, I also believe that we need a statutory solution that requires that financial firms provide employers with sufficient disclosures and other information so that the employers are able to make an informed decision before selecting a 401(k) provider. I also believe that participant disclosures should be enhanced, such that participants better understand the true cost of investing through a 401(k) plan. With better informed employers, and better informed 401(k) participants, over time, competitive market pressures will reduce the cost of 401(k) investing, thereby improving retirement security for all Americans.

Stories From the Trenches: Real World Examples of How Fiduciaries Currently Evaluate 401(k) Fees and Revenue Sharing Arrangements

I'd like to share a few examples about revenue sharing, and how it can be used positively or negatively, and how even the largest employers frequently misunderstand it.

Large Plan Uses Information About Revenue Sharing to Reduce Participant Costs

Recently we were engaged by a large 401(k) plan sponsor to help with investment issues relating to a fund mapping. This particular plan sponsor did not work with an investment consultant on a regular basis. Fiduciary investment reviews for this plan were conducted by the financial firm serving as the plan recordkeeper, in conjunction with the sponsor's own treasury staff. Since treasury staff also managed investment manager reviews for the company's defined benefit pension plan, they felt that they did not need an independent review of their 401(k) plan. In fact, this company would not have engaged an independent investment consultant had it not been for the need to do a mapping study. The company's contract with the financial firm serving as the plan recordkeeper provided for no explicit fee payments—recordkeeping and compliance services were covered by profit margins on the financial firm's proprietary funds, as well as revenue sharing payments from non-proprietary funds that were offered through the plan. The plan sponsor presumed that the plan fees must be reasonable, because the expense ratio on each fund offered through the plan, when considered in isolation, seemed reasonable.

As a tangential element of the mapping project for which we were engaged, we were able to demonstrate to this company that the total explicit and implicit revenue sharing used to support plan administration generated more revenue than the approximate "market rate" for the recordkeeping and compliance functions provided by the financial firm. Based on the information we presented, the company negotiated share class transitions that saved participants more than $1 million per year. We considered this a huge success. But the main point that I want to emphasize to this Committee is that, in this particular fact pattern, we were able to improve the 401(k) fee structure for a large group of plan participants that already benefited from low cost investment options, and from relatively sophisticated fiduciary oversight. This large employer simply did not understand revenue sharing arrangements well enough to negotiate further improvements without getting information from an independent investment consultant. Better disclosure of 401(k) fees could help many plans whose assets measure in the millions (or even in the hundreds of thousands), and not in the billions, to negotiate more favorable arrangements for their participants. Most of these smaller plans simply cannot afford to engage independent consultants to review their fee arrangements.

Smaller Plan Refuses Zero Fee Arrangement

I understand that certain commentators argue that the "unbundling" of fee arrangements proposed under H.R. 3185 is unnecessary, and could potentially lead to increased costs if plan service providers are forced to calculate what portion of an aggregate fee applies to specific service elements. These commentators argue that any new requirement should only require the disclosure of aggregate plan level fees. Additionally, some commentators argue that bundled providers are not able to determine how costs break down between investment and administrative services, so they cannot provide this information.

When we manage an RFP for a company, we typically include proposals from both bundled and unbundled service providers. Furthermore, we ask both the bundled and unbundled providers to separately propose fees for administrative and investment management services. This permits the fiduciaries selecting the vendors to make an informed decision regarding the cost and quality of each service element. In our experience, virtually all bundled providers are willing and able to propose services in this manner, although some bundled providers will only present "unbundled" pricing to larger plans.

Our experience managing an RFP process for a regional bank with about $15 million in plan assets earlier this year may help illustrate why we believe that any new disclosure requirements should require unbundling of fees. On behalf of the bank, we requested proposals from five different types of providers representing three different business models: large financial firms including two mutual fund companies and two insurance companies, as well as an unbundled arrangement led by an independent third party administrator (TPA).

One of the insurance companies refused to provide unbundled pricing, simply claiming that its fees would be zero. This proposal was rejected without further review. The second insurance company proposed a relatively high hard dollar fee under an unbundled pricing structure, with the hard dollar fee offset by any rev-

enue sharing payments received by the insurer. Alternately, this insurance company suggested that if the plan's current money market position were invested in a fixed rate account managed by the insurer, all explicit fees would be waived. This insurance company was invited to make a finals presentation to the plan fiduciaries.

The two mutual fund company proposals presented primarily unbundled pricing, with explicit fees that were somewhat lower than the second insurance company's unbundled pricing, but with a requirement that at least some of the fund company's own proprietary funds be offered through the plan. One fund company proposed lower hard dollar fees, but offered more expensive funds. The other fund company proposed higher hard dollar fees, but offered less expensive funds. The fund company with the lower cost funds was invited to the finals presentations.

The TPA was named as the third finalist. This proposal featured the lowest hard dollar fees of any of the three finalists, and complete flexibility for investment choice. Without knowing the identity of the other finalists, the TPA suggested that funds from the low cost fund company would be good investment choices.

In this case, the bank selected the low cost fund company as its new 401(k) provider. While the TPA presented the least expensive and most flexible proposal, the bank was concerned that the TPA's administrative capabilities did not appear to be as deep as the fund company's.

Conclusions

401(k) fees have been identified as a potential problem for at least a decade. The Department of Labor and the ERISA Advisory Council have focused on this topic since at least 1997. However, other than educational initiatives, very little real progress has been made towards rationalizing, or even better understanding, 401(k) fee structures. In the past five years, 401(k) fee issues have become even more prominent, and it appears that the Department of Labor is now poised to release a series of regulations that will improve 401(k) fee disclosure. However, various commentators have noted that the Department's proposed regulations may be insufficient to address many of the issues faced by employers today, such as properly comparing bundled and unbundled service arrangements. In fact, it appears that the Department's proposed regulations will require less disclosure from bundled arrangements than will be required from unbundled arrangements. Such an uneven disclosure regimen could have the unintended and unwarranted consequence of favoring one type of service provider over another, which could lead to reduced competition and higher fees.

In its current form, H.R. 3185 may not be a perfect bill. The litany of required fee disclosures may be excessive, and it's possible that certain types of fee disclosures could be collapsed and streamlined to reduce costs of complying with the bill and to improve the comprehensibility of the fee disclosure. The basic concepts behind H.R. 3185, however, the concepts of increased disclosure of fees and costs to 401(k) plan fiduciaries and 401(k) plan participants, are, in my opinion, quite sound and are badly needed to protect and improve the retirement security of American workers,

I would like to add that the current bill's proposed requirement that 401(k) plans include some form of balanced index fund might establish a dangerous precedent for statutory endorsement of specific investment approaches. In my view, it is better to let the competitive and ever changing forces of the marketplace, with enhanced and effective disclosure of 401(k) fees and investment costs, drive the choice of investment vehicles for 401(k) plans. As a practical matter, if H.R. 3185 or a similar bill is enacted, we are likely to see index funds featured more prominently in 401(k) plans simply because the enhanced disclosure regimen makes low cost index funds look relatively attractive, and not because the statute requires that they be offered.

Chairman MILLER. Thank you very much.

Thank you all for your testimony and your insights.

Let me explain the situation to the committee and to the witnesses. We are going to begin a series of six votes here that I believe will take us a good part of 1 hour. We are going to begin the round of questioning and go as long as we can so that members can still make the votes, but I think at that point I will ask the members whether or not we let the panel go, rather than sit here for 1 hour. We would obviously like to be able to submit questions to you in writing, but I just think it would be unfortunate if we had you hang in here for 1 hour. I don't know that 1 hour will be

enough time, unfortunately, with the way the votes are currently structured.

If that meets with the approval of the members of the committee and with the witnesses—I can see that you are crestfallen that you are going to get out of here in a few minutes. [Laughter.]

Okay, we will stick around and you guys will wait here 1 hour. No. [Laughter.]

Okay. We will do it that way. I will try to abbreviate because I know there is interest among the members here.

Just quickly, Mr. Thomasson, if I might just ask you, the suggestion is made time and again that this is all information that the average person won't understand, can't use or won't use, and really doesn't provide any additional insights for them in the management of their plans. I would say in some cases that even suggests for the sponsors of the plan speaking to the individual. Yet we see from the GAO report and from calculations that many people have done a small differential can mean a lot of money over a period of years. I just wondered if you might explain. You have handed out how you thought it could be done with your testimony, but if you might explain your take on the question of complexity and whether this is all too much for the consumer.

Mr. THOMASSON. Thank you very much, Mr. Chairman. There are two levels of disclosure, as illustrated in the bill itself. One is a plan fiduciary disclosure. The other is a participant disclosure. While recordkeeping services, recordkeeping administration and some investment services are complex from the standpoint of being able to explain it, with multiple categories of fees and expenses, we think and we believe that a summary of these fees on the plan sponsor side, from the standpoint of investment management, recordkeeping and administration, as well as selling advisory services, are the three categories that are what plan sponsors need information on to be able to evaluate different service providers.

They have an obligation to do so. If they do not have a breakdown of some type to be able to evaluate plan operations, selling and advisory fees, and the investment management itself, then they have no comparison with which to delineate whether a certain provider is better than another.

Now, that does not preclude the fact that in either case, a plan sponsor will roll out and eventually have a total overall cost, but the comparison for their fiduciary responsibility to determine whether a service from a provider is appropriate, they need that breakdown.

On the participant side, we agree that participant activity is really driven by the type of information they get. There are studies that say the participant disclosures, if they are too much for them, it actually will not be in their best interest to deliver that information to them because they will not be able to make appropriate decisions.

What we have done and what we think is appropriate from the participant perspective is to examine what participants really need to make those decisions. Now, keep in mind that when a participant even gets the opportunity to make a decision, the universe of choices that they make has already been selected for them by the plan fiduciary. If a fiduciary selects a plan provider or a set of serv-

ices and investments from a specific provider regardless of whether they are bundled, unbundled, or whoever they are, those decisions have already been made.

So whatever that provider gives them, whatever the investments that have been selected, that is the universe that participants are able to choose from. Therefore, there is a subset of things that participants need to make those decisions. The investment expenses are obvious. In a situation where participants need to select the investments on their own behalf for their retirement security, they need to know what that management cost is going to be.

If there are other fees on total plan assets—in other words, wrap charges, other types of fees that are assessed against the entire account as a plan or against individual participant accounts or against individual investments, they need to know what those are. And then the summary of those two together is total investment fees.

In addition, since participants have the ability to execute instructions or give instructions to the provider or to the plan sponsor fiduciary relative to activities that they want to undertake, such as distributions or loans or initiate a loan process or other items like that, a fee menu of transaction expenses is kind of like a menu at a restaurant. It is something that they understand they need and they will say, “Okay, I will be charged this if I initiate this transaction.”

So those are three categories that we think need to be done—the investment expenses with all the fees on plan assets and the fee menu itself.

Chairman MILLER. Thank you.

Mr. McKeon?

Mr. MCKEON. Thank you, Mr. Chairman. I agree with your decision. It is unfortunate that the votes were called at this time because this is an outstanding panel, and I would like to hear more from them. Maybe we could, at some other day, continue this discussion, because they have a lot to tell us about this.

I am going to go as quickly as I can. One of the things that I noticed in most of your testimony, you are really talking a lot about fees. I heard very little about net return. If a fee is ½ point and the return is 10 percent; if the fee is 1 point and the return is 20 percent, I think that is what is most important to the ultimate beneficiary. I would really like to get into this a lot more.

Also, some funds obviously have higher returns than others. We have been talking kind of like everything is kind of the same, and that kind of information needs to be disclosed.

We have two members—I would like to yield my time to Mr. Kline and Mr. Castle. They have some specific questions they would like to ask, if that is all right, Mr. Chairman.

Mr. KLINE. I thank the gentleman for yielding.

Just a quick comment. I couldn’t help but notice, Mr. Certner, when you were talking about the AARP survey, that you had an astonishing number of participants who didn’t know the names of their funds; didn’t know if they were equity; didn’t know if they were bond. And yet we are going to give them numbers on recordkeeping, and office supplies and so forth that I think is just a tad too much.

Clearly, a subject of interest that has gone up and down the table is the issue of bundling. There must be some advantages to bundling. I wonder, Mr. Minsky, if you could tell us, is there an advantage or should we just spread this all out in a big laundry list?

Mr. MINSKY. Thank you, Congressman.

I think it is a difficult question for me to answer because I am not a service provider, but let me give you my perspective as a plan sponsor, which is that I think in any arrangement, it is really degrees of bundling. I have yet to see in my experience any relationship with a service provider that is completely unbundled. There are always some services that are included and some that are not.

So for me, it is really more a question of the level of transparency, and that is what the business model is. I think for plan sponsors of different sizes, the degree of bundling or unbundling that makes sense will vary. For each individual situation, it will vary. I think Mr. Chambers raised a really interesting point, with a much smaller plan than ours, which is that they had a competitive process. They saw a number of business models, some that were more bundled than others.

Ultimately, they chose a service provider that was slightly more expensive than the least-bundled one. My guess is that for them, that made a lot of sense because of the services being provided. I think that is an appropriate decision for a plan sponsor and a plan fiduciary to make.

Mr. KLINE. Thank you.

Mr. CHAMBERS. Could I comment just briefly on that?

Chairman MILLER. I am very concerned about our time for responses to these from other members. Excuse me.

Mr. CASTLE. I will be brief, and I will submit a question in writing, which you can respond to. It is a little bit off the subject, perhaps, so I will just state what it is going to be about.

I think we basically are running into what is going to be a crisis in this country. I speak to many retired individuals or people getting ready to retire who believe that Social Security is going to be sufficient for them to live on. I think Mr. Miller in his opening statement indicated the amount of money that people have in their 401(k) plans, and while a lot of people have 401(k) plans, there are people who do not have 401(k) plans. We can worry about the actual information which is reported to them, which is what the legislation is all about, and I have no particular judgment about that, except that hopefully competition would make that work. I think it should be clearer than it is.

But I am very concerned about what we are doing to make sure that people understand that they are not going to have a defined benefit, that Social Security probably will not be enough, and they better have a 401(k) plan for their future, and make absolutely sure that that is being told to these folks out there. I am not just worried about the details of the investment. I am worried about the people who are not in it.

Mr. Certner indicated how many people are in it, but I am worried about all those who are not in it, who need to be in it. And they need to understand how much money they are going to need. Do they really understand what happens at the end of it when they

get to be 65 years of age and they have $20,000 in the plan, what do they expect to get from that?

So I am going to ask you what is being done about spreading that information, because we need to do something in this country if we are going to be able to meet the needs of our senior citizens when they retire.

Chairman MILLER. Mr. Andrews?

Mr. ANDREWS. Thank you.

We have read your testimony. We appreciate it. This is the lightning round.

So Mr. Scanlon, am I correct in reading your testimony that you do think there should be a distinction between what is disclosed to plan sponsors and what is disclosed to participants. Is that correct?

Mr. SCANLON. Yes, and let me explain that. We believe that plan sponsors, being fiduciaries, are in a position to disclose information to their participants in a format that allows comparability——

Mr. ANDREWS. Right.

Mr. SCANLON [continuing]. And allows the individual participant to make the best choices against other competing choices.

Mr. ANDREWS. I do appreciate it. I didn't want to rush you.

Mr. Minsky, Mr. Scanlon suggests a disclosure to employees, which if I understand it, has three pretty simple categories: recordkeeping, money management and other. What is wrong with that? What would be wrong with presenting those three generic categories?

Mr. MINSKY. I am not sure that anything is inherently wrong with that. It is just that the devil is in the details with regard to "other." My only concern is that we not provide participants with disclosure that confuses them and ultimately leads to them making irrational decisions.

Mr. ANDREWS. And finally, very quickly, Mr. Thomasson, do you support requiring funds to offer an index fund as one of the options for investors?

Mr. THOMASSON. Thank you, Congressman.

I might pass that over to Mr. Chambers, who is the investment advisor.

Mr. ANDREWS. Do you, Mr. Chambers?

Mr. CHAMBERS. Frankly, sir, I don't believe that it is necessary. At the same time, I think that index funds would be far more prevalent in 401(k) plans than they are today if H.R. 3185 were enacted, simply because the disclosures would lead people to select index funds.

Mr. ANDREWS. Thank you very, very much.

Gentlemen, thank you.

Chairman MILLER. Thank you again. My apologies. These votes were supposed to be here later this afternoon, but here we are this morning. I thank you very much for taking time to come before the committee.

We will keep the record open for 14 days for those who want to make submissions. We will be contacting you with some questions that I know that I have. So thank you very much.

[The statement of Mr. Altmire follows:]

Prepared Statement of Hon. Jason Altmire, a Representative in Congress From the State of Pennsylvania

Thank you, Mr. Chairman, for holding this hearing on the 401(k) Fair Disclosure for Retirement Security Act of 2007 (H.R. 3185).

As we discovered in our previous hearing on 401(k) plans, the fees associated with these plans vary greatly and can have a significant impact on the amount of money participants are able to accumulate in their plans. Further, because 401(k) plans have become the primary way that most Americans save for retirement, the amount of money employees are able to accumulate in these plans directly relates to their retirement security.

I am pleased that Chairman Miller has offered legislation that will increase the disclosure of 401(k) plan fees, potentially helping plan sponsors and plan participants make better investment decisions. I look forward to hearing more from our witnesses on how the specific provisions in the 401(k) Fair Disclosure of Retirement Security Act will impact 401(k) plan administrators, sponsors and participants. In particular, I am interested in hearing more about what amount of information should be disclosed to plan sponsors and plan participants.

Thank you again, Mr. Chairman, for holding this important hearing. I yield back the balance of my time.

[Additional submissions from Mr. McKeon follow:]

Prepared Statement of the American Benefits Council and American Council of Life Insurers and Investment Company Institute

The role of section 401(k) plans in providing retirement security has grown tremendously over the last 25 years and is continuing to grow. In that light, legislative and regulatory actions with respect to such plans similarly take on an increased importance. Applicable legislation and regulations should ensure that these plans function in such a way as to help participants achieve retirement security. At the same time, we all must bear in mind that unnecessary burdens and cost imposed on these plans will slow their growth and reduce participants' benefits, thus undermining the very purpose of the plans.

It is in this spirit that the American Benefits Council (the "Council"), the American Council of Life Insurers ("ACLI"), and the Investment Company Institute ("ICI") submit this statement with respect to H.R. 3185, the 401(k) Fair Disclosure for Retirement Security Act of 2007.

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

The ACLI represents 373 member companies accounting for 93 percent of the life insurance industry's total assets in the United States. Life insurers are among the country's leaders in providing retirement security to American workers, providing a wide variety of group annuities and other products, both to achieve competitive returns while retirement savings are accumulating and to provide guaranteed income past retirement.

ICI is the national association of U.S. investment companies, which manage about half of 401(k) and IRA assets. ICI advocates policies to make retirement savings more effective and secure.

Legislative and Regulatory Processes

At the outset, we want to address the legislative and regulatory processes with respect to plan fees. Chairman Miller has introduced H.R. 3185, which addresses the disclosure of plan fees by a service provider to a plan administrator, as well as the disclosure of plan fees by a plan administrator to participants. Other Committees and Members have also indicated interest in exploring the issues related to disclosure of plan fees. In addition, the Department of Labor has been working on regulatory initiatives with respect to plan fees. The Department's initiatives address three issues: the same two issues addressed by Chairman Miller's bill plus plans' obligations to report plan fees to the Department and the Internal Revenue Service on the annual Form 5500.

We have been very active participants in the legislative and regulatory processes. For example, we have participated with other trade groups in providing extensive input to the Department on their initiatives.

The Department is nearing completion of the Form 5500 project. The Department will likely, in the next month or two, issue proposed regulations relating to disclosure of plan fees by service providers to plan fiduciaries. We understand that the Department intends to issue proposed regulations on disclosures to plan participants in late 2007 or early 2008.

We support improvement to the rules regarding plan fee disclosure. Effective plan fee disclosure to participants can enable them to understand their options and choose the investments best suited to their circumstances. Disclosure to plan fiduciaries equips fiduciaries to negotiate and shop for the best services at reasonable prices. In addition, clarity with respect to both sets of rules can provide plan fiduciaries with a means of helping their participants without incurring potential liability.

In the effort to improve the fee disclosure rules, we believe that it is very important that the legislative and regulatory processes be coordinated. For example, it would be very harmful for the system for one set of rules to apply for a year or two, only to be supplanted by a different set of rules. The additional programming and data collection costs caused by such a scenario would be enormous, not to mention the resulting confusion among participants and plan fiduciaries. Such cost would, of necessity, be absorbed by plan participants or possibly to some extent by plan sponsors. Plan sponsors could react by reducing benefits and possibly even eliminating or failing to adopt plans; plan participants would simply receive smaller benefits, which would be very unfortunate.

Accordingly, we urge both Congress and the Department to consider how best to coordinate their efforts to avoid very adverse consequences.

Plan Fee Issues

We welcome this opportunity to share our views on H.R. 3185. We very much appreciate the open manner in which Chairman Miller has invited input on his bill.

We present our views in the context of a list of principles that we believe should guide the development of plan fee disclosure rules. This is not by any means a comprehensive list; we would, of course, be very pleased to work with the Committee on additional important issues related to plan fee disclosure.

Disclosure to Plan Participants

At the outset, it is critical to emphasize that the disclosure rules should take into account the sharply different circumstances of participants and plan fiduciaries. Participants need clear, simple, short disclosures that effectively communicate the key points that they need to know to decide whether to participate and, if so, how to invest. Excessive detail can prevent employees from reading or understanding the disclosure and can also serve to obscure key points. Plan fiduciaries need more detailed information since it is their duty to understand fully the options available and to make prudent choices on behalf of all of their participants.

We support improved disclosure of plan fees to participants (and improved disclosure to plan fiduciaries, as discussed below). As noted, participants need disclosures that are simple and concise. At the same time, however, participants need to understand the fees they are paying within the context of the investment and other services they are receiving. This means that participants must recognize that fees are only one factor to consider in choosing an investment option. Fee disclosure must not be elevated in a manner that discourages plan participants from considering potential or expected investment returns, their projected retirement date, their risk tolerance, and other factors when making investment decisions, as well as decisions regarding participation in, contributions to, and distributions from the plan.

In this context, we offer the following principles that we believe should guide plan fee disclosure rules with respect to participants. In connection with each principle, we discuss briefly our concerns with H.R. 3185.

• The disclosure needs to be short, simple, and easy to understand. As noted, H.R. 3185 requires extensive fee disclosure. We believe that participants will be far more likely to read and use information that is shorter and simpler. One possible solution could be to require affirmative delivery of basic fee information and make more comprehensive fee information available on request.

• Disclosure should include key information important to participants, generally including, for example, the investment objectives, risk level, fees, and historical returns of investment options. Undue emphasis on fees will only mislead participants by elevating fees above other equally or more important factors. We are concerned that the volume of fee information required by H.R. 3185 outstrips the volume of other information, such as information regarding investment objectives, historical return, and risk level. This over-emphasis on fees could cause participants to make imprudent choices or possibly could cause them not to participate in the plan.

Again, one possible solution could be to require affirmative delivery of basic fee information and make more comprehensive fee information available on request.

- Reform of existing rules regarding electronic communication is needed to facilitate less expensive, more efficient forms of communication, including the use of internet and intranet postings. Consideration should be given to adopting rules at least as workable as the Internal Revenue Service's rules regarding electronic communication. Such rules ensure that electronic communications are only used with respect to participants who can access such communications; at the same time, the Service's rules are also generally workable for plans. H.R. 3185 does not address electronic communication. Without the effective ability to use electronic communication, compliance with extensive new disclosure rules would be unreasonably costly and burdensome.
- Participant-level disclosure rules should apply to all participant-directed plans not just 404(c) plans. H.R. 3185 applies the disclosure rules to all participant-directed plans.
- Fee information should be provided upon enrollment and updated annually. H.R. 3185 is generally consistent with this principle. However, on a related note, it is critical that the annual benefit statement required by H.R. 3185 be coordinated with the existing benefit statement requirements. Fee information should be disclosed in the manner in which fees are charged. Artificial division of a single fee into components that are not available separately is costly and serves no purpose. This issue applies to disclosure both to participants and to plan fiduciaries. Because it applies more acutely in the latter context, it is discussed below.
- Where disclosure of exact dollar amounts would be costly, the use of estimates or examples based on prior year data should be permitted. H.R. 3185 can be read to require the exact dollar amount of fees to be determined for plans and for participants. This could be enormously costly. For example, for participants moving in and out of investment options all year, determining the precise dollar amount of fees charged for the year would require tremendous work as well as new recordkeeping systems. Very helpful fee information can be conveyed efficiently through the disclosure of expense ratios and reasonable estimates; the cost of turning those estimates into precise numbers would be very high and clearly not justified by the marginal difference between a reasonable estimate and the exact number.
- Plan fiduciaries should retain flexibility to determine the format for disclosure based on the nature, expectations, and other attributes of their workforce. H.R. 3185 generally does not require a specific format for disclosure.
- The rules must be flexible enough to accommodate the full range of possible investment options. H.R. 3185 establishes a very detailed disclosure regime that will not be able to cover all the products that are or may be used in the 401(k) plan market. While it seeks to set out specific disclosure elements for many investment products used in 401(k) plans today, the bill's framework does not easily accommodate certain other products, such as those providing a guaranteed rate of return based on the general assets of the provider. The framework also may be inadequate or inappropriate to address new types of products that may develop. We would be pleased to continue working with this Committee on how to address these issues.

Disclosure by Service Provider to Plan Fiduciary

We support improved disclosure of plan fees by service providers to plan fiduciaries. Plan fiduciaries need fee information in order to negotiate and shop effectively for services. In this regard, we offer the following guiding principles and related comments on H.R. 3185.

- Fee information should be disclosed in the manner in which fees are charged. Artificial division of a single "bundled" fee into components that are not available separately serves no purpose. Service providers should be required to disclose what services are included in the "bundle" and what services can be purchased separately by the plan fiduciary. H.R. 3185 can be read to require "unbundling the bundle", i.e., to require that a service provider ascribe separate fees to services that are not sold separately by the service provider. This is not meaningful information. It is burdensome and costly to produce; it has no significance since the services cannot be purchased separately from the service provider; and accordingly, it would not further fiduciaries' understanding of their options.

Plan fiduciaries can reasonably make the decision whether to purchase services on a bundled or unbundled basis. Some fiduciaries believe, for example, that bundling provides economies of scale and facilitates efficient shopping for service providers, especially with respect to plans maintained by small employers. In some circumstances, it may be easier and more efficient to compare service providers that provide bundled services than to construct a full array of plan services from mul-

tiple vendors and to try to compare services from such vendors that are significantly different in scope.

A plan fiduciary purchasing services on a bundled basis retains the duty to determine if (1) the bundled package of services is appropriate for the plan, and (2) the bundled price is reasonable, both initially and over time. This will require the plan fiduciary to monitor, for example, whether any asset-based fees continue to be reasonable, especially with respect to services that do not vary based on the size of the plan assets. Again, for some fiduciaries, those monitoring tasks may be simpler in the bundled context than where there are multiple providers with respect to a single plan.

- Where disclosure of exact dollar amounts would be costly, the disclosure of fee formulas should be permitted. As in the case of participant disclosure, disclosure of exact fee dollar amounts to plan fiduciaries could be extremely expensive in circumstances where fees are based on a percentage of assets. Plan fiduciaries only need the fee formula (such as the basis points charged); that gives them all the tools they need to evaluate the cost of the service. The high cost of calculating exact dollar amounts clearly outstrips the value of such exactitude.
- Disclosure of revenue sharing received by plan service providers from third parties should be required. Disclosure of the affiliation between two or more service providers should also be disclosed. However, payments from one service provider to another affiliated service provider are not revenue sharing and should not be required to be disclosed. H.R. 3185 can be read to require payments among affiliates to be disclosed. Affiliates are part of one economic unit, so that any explicit payments between them may not reflect an arm's length transaction and thus may have little or no significance. Moreover, financial relationships between affiliates can be complex, including numerous non-market transactions, such as the exchange of services without any charges; in this context, calculating the value of "revenue sharing" would require identifying and valuing all of these non-market transactions and would thus be enormously difficult and uncertain.

In short, determining the value of intra-affiliated group payments would be costly and filled with speculation and uncertainty. Also, in light of the relationship between the entities, such payments are not revenue sharing in a true sense. We look forward to working further with the Committee on this issue.

- Fees paid by plan sponsors should not be subject to any of the disclosure rules. Where plan assets are not involved, ERISA's rules are not implicated. H.R. 3185 should be clarified in this regard.
- Fees charged by service providers to plans should be disclosed. Fees charged to service providers by their suppliers have no relevance to plans and should not be required to be disclosed. H.R. 3185 can be read to require disclosure of a service provider's transactions with almost all of its suppliers, which could be a huge number. These suppliers have no contractual relationship to the plan, thus making the massive disclosure requirement meaningless for the plan.

Investment Option Requirement

H.R. 3185 requires one specific type of index fund to be offered under all participant-directed plans. This would set a dangerous precedent, as it would (1) substitute Congress' current judgment regarding investments for the judgment of plan fiduciaries who are familiar with their workforce and (2) establish an investment rule based on today's thinking that does not take into account future investment trends and principles. This provision could also send a signal to participants that this particular investment option is the best one, despite the fact that another option might better fit their circumstances.

We urge that this provision be deleted.

"Conflicts of Interest"

H.R. 3185 requires disclosure of conflicts of interest to both participants and plan fiduciaries. Conflicts of interest are prohibited by ERISA's prohibited transaction rules, so it is not clear which if any permitted practices must be disclosed under these rules. The disclosure rules in H.R. 3185 may simply be aimed at requiring disclosure that a service provider is selling its own products or the products of an affiliate or business partner. If so, it is very important that a different term—- other than "conflict of interest"—- be used. As long as a service provider is not acting as a fiduciary, selling its own products or those of an affiliate or business partner is simply selling, not a conflict of interest. Labeling such actions as a conflict of interest is technically incorrect and will create confusion for all parties, including participants who could be unnecessarily discouraged from participating in the plan.

Effective Date

Any revisions to the fee disclosure rules will require (1) interpretation and implementation by the Department of Labor, (2) extensive systems changes, and (3) development of effective communication methods. Accordingly, it is critical that legislation not be effective prior to plan years beginning at least 12 months after the publication of final regulations interpreting the legislation.

[FILED ELECTRONICALLY],
July 24, 2007.

U.S. Department of Labor Employee Benefits Security Administration, Office of Regulations and Interpretations, Constitution Avenue, NW, Washington, DC.

Attention: *Fee Disclosure RFI*

Re: *Fee and Expense Disclosures to Participants in Individual Account Plans*

DEAR SIR OR MADAM: The undersigned twelve organizations representing both employer sponsors of defined contribution retirement plans as well as the financial institutions that provide services to such plans respectfully submit the attached joint recommendations in response to the Request for Information ("RFI") issued by the Department of Labor (the "Department") regarding fee and expense disclosures to participants in individual account plans, published at 72 Fed. Reg. 20,457 (April 25, 2007). We appreciate the opportunity to provide input on this important matter.

Several of the undersigned organizations worked together last year to develop and submit joint recommendations and a fee and expense reference tool with respect to the Department's ongoing project under ERISA Section 408(b)(2) related to fee disclosure between plan fiduciaries and service providers. With the same goal of achieving consensus on how to enhance fee disclosure, an even broader group of interested organizations has worked together over the past several months to develop joint recommendations regarding participant-level disclosure of defined contribution plan fee information. On this important issue, our organizations believe the Department has both the statutory authority and institutional expertise to improve disclosure of fee information to participants without new legislation. We hope the attached recommendations, which have the support of this broad array of organizations active in the retirement policy arena, will be of significant use to the Department as it considers what changes to current disclosure requirements may be appropriate.

Our organizations would welcome the opportunity to meet with Department officials to discuss the attached recommendations and will plan to be in contact in this regard. In the meantime, please feel free to contact any of the individuals and organizations listed below.

Sincerely,

AMERICAN BANKERS ASSOCIATION,
AMERICAN BENEFITS COUNCIL,
AMERICAN COUNCIL OF LIFE INSURERS,
COMMITTEE ON INVESTMENT OF EMPLOYEE BENEFIT ASSETS,
ERISA INDUSTRY COMMITTEE,
FINANCIAL SERVICES ROUNDTABLE,
INVESTMENT COMPANY INSTITUTE,
NATIONAL ASSOCIATION OF MANUFACTURERS,
PROFIT SHARING/401(K) COUNCIL OF AMERICA,
SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION,
SOCIETY FOR HUMAN RESOURCE MANAGEMENT,
U.S. CHAMBER OF COMMERCE.

Joint Submission to the Department of Labor:

Recommendations for Participant-Level Disclosure of Defined Contribution Plan Fee Information

• Disclosure Regarding Fees is Important to Defined Contribution Plan Participants. An increasing number of Americans rely on employer-sponsored defined contribution plans (such as 401(k)s) to help them accumulate the savings they will need for a secure retirement. Many defined contribution plan participants make their own investment elections from among the options offered by the plan and it is important that they have appropriate information to assist them in making these decisions. Disclosure about the fees associated with the plan and its investment options are an important component of this information. All defined contribution plans have costs. Participants often pay these costs under arrangements that differ from plan to plan. We believe it is beneficial for participants to have a general understanding

of their plan's fee structure and the overall magnitude of the costs they bear as well as to receive fee information that is material in selecting specific investments for their accounts. Disclosure requirements should be evaluated based on whether information provided will be useful to typical plan participants in making investment selections. The benefits to participants should be real rather than hypothetical. More disclosure will not always be better. Under existing legal standards, plan fiduciaries (typically the employer plan sponsor) and service providers have worked hard to provide participants with meaningful, clear and concise information about key characteristics of plan investment options, including fees, and they continually seek to enhance these disclosures. Our organizations are eager to work with policymakers to improve existing legal standards regarding disclosure, where appropriate, to ensure that participants have information to make sound investment decisions. Any prospective enhancements to current law should foster simplicity, flexibility and efficiency in fee disclosure so that the result is a stronger defined contribution system for plan participants rather than one weakened by complex and costly disclosure that fails to serve participants' interests.

- Enhanced Disclosure Requirements Regarding Fees Should Extend to All Participant-Directed Retirement Plans. New fee disclosure requirements should apply to all participant-directed individual account retirement plans subject to the Employee Retirement Income Security Act of 1974 (ERISA) rather than only to ERISA 404(c) plans. In this regard, the Department of Labor (DOL) has the authority to promulgate disclosure standards for all participant-directed individual account retirement plans under ERISA.[1] The focus of policymakers should be on improving disclosure practices in all participant-directed plans, as this will serve participants' interests more than a detailed reworking of the ERISA 404(c) regulations.
- Fee Disclosure to Participants Serves Different Needs Than Fee Disclosure to Plan Fiduciaries. The purposes behind fee disclosure to plan fiduciaries and plan participants are fundamentally different. In selecting and monitoring service providers and in selecting a plan's menu of investment options, plan fiduciaries engage in acts subject to ERISA-imposed obligations, including to act prudently and in the best interest of participants, to pay no more than reasonable compensation and to avoid prohibited conflicts of interest. Such fiduciary determinations are aided by having detailed information about the services provided, fees charged and compensation earned by plan service providers (including through revenue sharing from third parties). Participants, on the other hand, do not select among service providers or determine the menu of plan investment options. They choose investments for their account from a menu of plan investment options selected by the plan fiduciary. The fees associated with the plan and its investment options are only one of a number of important criteria for making sound investment decisions. The voluminous and detailed information about plan fees and provider compensation (including revenue sharing) that is typically appropriate for plan fiduciaries to consider will not help participants select among plan investment options. Rather, providing this detail to plan participants could impair sound decision-making by overloading them with information, elevating fees above other investment selection criteria (which can produce poor investment decisions) and contributing to the decision paralysis that keeps some participants from joining plans. In light of the many other disclosures plans are required to provide to participants, an additional notice that is unduly detailed or technical will often be a source of aggravation to participants, reducing their interest in plan information generally. Policymakers should keep in mind the distinct purposes behind plan fiduciary and plan participant fee disclosure as they craft new participant disclosure rules.
- Disclosure to Participants Should Include Expenses That Affect Participants' Choices. Participants should be informed of the asset-based fees they will be charged for participating in the plan (typically expressed as a rate, in basis points), whether such fees are levied by particular investment options or charged regardless of the specific investment options selected by the participant. Fee disclosure to participants about investment options should also include any additional per-participant charges associated with the investment, such as charges for buying, selling or redeeming the investment (such as front- and back-end sales charges, redemption fees and market value adjustment charges). Plans also should inform participants about the existence of any plan administration or ongoing service charges that par-

[1] DOL has authority under ERISA Section 505 to require that all participants who have the right to direct investment of their accounts have basic information about plan investment options. ERISA Section 505 grants DOL authority to issue such regulations as are necessary or appropriate under Title I of ERISA, which includes the statute's fiduciary responsibility requirements. In addition, ERISA Section 109 grants DOL authority to prescribe the content of various reports and documents, including materials furnished or made available to participants.

ticipants will pay on a per account (rather than an asset-based) basis. In some plans, asset-based charges on investments not only finance investment management but also defray other plan costs (such as plan administration). Where this is the case, participants should receive a general disclosure that the asset-based fees on investments defray other plan costs. More detail about the components of asset-based fees is not relevant to the total cost of investing, which is the information participants need. By disclosing the rate of asset-based fees together with information on any additional per account administrative charges, participants will be provided with a clear understanding of the costs of investing under the plan. Participants should also be informed that some transactions or services (e.g., plan loans or use of investment advice, managed account or brokerage window services) will result in additional charges to participant accounts, the specifics of which will be disclosed at the time the participant uses these services. Because most of these transactional charges will never apply to most participants, requiring detailed disclosure to all participants as to the specifics of such charges would make fee disclosure cumbersome and obscure the core information. Detailed information about costs for participant-initiated transactions and services should be made available upon participant request and provided at the time of the transaction. Plan fiduciaries should have flexibility to determine the precise form of the key fee disclosures discussed herein based on the facts and circumstances, but they will typically be expressed as a rate (in basis points) and/or as an illustrative dollar charge.

- Fee Information Should Appear Alongside Other Key Information Participants Need to Make Investment Decisions. Fees should be disclosed along with other information participants need to make informed investment decisions. Fee information should not be elevated so as to suggest that fees are the most important factor in selecting investments from among the plan's options. An undue focus on fees in new required disclosures might encourage participants to select the plan's lowest-cost investment option, which may not be the best choice for a participant. Instead, fees associated with a plan's investment option should be disclosed together with other key information: the option's investment objective and product characteristics, its historical performance and risks and the identity of the investment advisor or product provider. This information should be conveyed in clear and simple terms, and plan fiduciaries should have flexibility to determine the format in which the information is communicated to participants. Web-based disclosure of information about investment options will often be the most useful because it permits participants to browse multiple interrelated pieces of information and access more detailed information about a given investment option or topic of interest to them.
- Policymakers Should Be Sensitive to Costs When Imposing New Disclosure Requirements. While participant disclosure should provide sufficient information on fees and other key investment option characteristics for participants to make sound investment decisions, new disclosure requirements come with added costs. Such costs must be justified in terms of providing a material benefit to participants selecting among plan investments. The costs of some potential disclosure requirements would simply be exorbitant and unjustified. Any new disclosure requirements necessarily will impose expenses and burdens on both plan sponsors and plan service providers and will come on top of the multitude of new and costly disclosures required under the Pension Protection Act of 2006. The costs of new disclosure requirements are likely to be reflected in higher prices for plan administrative services, which are payable from plan assets. As a result, in many defined contribution plans the added costs of new disclosure requirements are likely to be borne in substantial part by plan participants. Plan fiduciaries and providers also will be concerned that expanded disclosure requirements could result in new and costly liabilities, a result that would further increase expenses in the system. New disclosure costs and potential liabilities could deter some small employers from sponsoring a qualified retirement plan for employees. Given these considerations, it is imperative that new participant disclosures be focused squarely on providing participants with information that will actually be useful in making investment decisions.
- Use of Electronic Technologies to Provide Plan Investment and Fee Information Should Be Strongly Encouraged. One important way to reduce costs and provide more useful information is to take full advantage of electronic mechanisms for delivering and providing access to information. New rules should move beyond existing regulations to permit, and indeed encourage, employers to use internet or intranet posting to deliver and provide access to fee and other information on plan investment options. (We recognize that certain participants without computer access will continue to need access to paper copies.) Notifying participants about the posting or availability of required disclosures on websites will typically be the most inexpensive method of delivery and should be promoted under new disclosure rules. As is common today, plan fiduciaries will work with service providers to provide required

information on plan investment options to participants and should be able to connect participants directly to content on the websites of service providers (via click-through web links or otherwise) rather than having to maintain all information on plan investment options and fees on their own internet or intranet site.

• Disclosure of Fees and Other Plan Investment Information Should Facilitate Comparisons. While plan fiduciaries should retain flexibility to determine the specific format for communicating fee and other plan investment information to their particular participant population, they should strive to disclose the information in a form that facilitates comparison across the plan's investment options. At the same time, unique features of particular investment options also would have to be communicated. Web-based disclosure methods and tools are likely to be the most useful as they can visually convey the full range of plan investment options while allowing participants to access more detailed information about each option via click-through web links.

• Participants Should Have Access to Fee and Other Investment Information at Enrollment and Annually Thereafter. Participants should receive disclosure about plan fees (asset-based fees, transaction charges associated with investment options, any separate per account administrative fees and the potential for participant-initiated transaction and service charges) and the other key characteristics of investment options when they enroll in the plan and select plan investments for the first time. Some plans, particularly ones that have formulas for reducing plan fees as assets grow, will not know in advance the exact asset-based or per account fee levels that participants can expect in the year ahead. As a result, plan fiduciaries should be permitted to use fee levels from the most recently concluded plan year in the fee disclosures they make to participants at enrollment. In addition, on an annual basis, plan fiduciaries should inform participants where they can find or how they can request updated information on fees and other characteristics of plan investment options (by providing a click-through web link or directing them to an internet or intranet website, telephone number or plan official). Plan fiduciaries should have flexibility as to whether to make this annual disclosure—regarding where participants can find or how they can request such information—a stand-alone communication or a component of an existing disclosure document. Plan fiduciaries should ensure that the underlying general information on fees and other characteristics of plan investment options is updated annually to reflect any changes.

• Plans Should Disclose to Participants Administrative and Transaction Dollar Charges Deducted from Participant Accounts. Participants should receive disclosure regarding any administrative or transaction flat dollar charges that have been deducted from their accounts. Such charges would include per account flat dollar charges imposed on all participants for the costs of plan administration as well as any dollar charges that result from purchases or sales of particular investments or from participant-initiated transactions or services (such as plan loans). Plan fiduciaries should have flexibility as to the means and timing of such disclosures. For example, some fiduciaries may include this information in quarterly benefit statements while others may include it in a confirmation notice following a particular transaction.

• Participants Have Access to Education Materials that Provide Context for Fee and Other Plan Investment Information. Participants make the best use of information about their plan investment options (including information regarding fees) when this information builds on basic investment education. The Pension Protection Act of 2006 (PPA) requires that participants have access to investment education materials and a new requirement in this area is not needed. Under PPA, the quarterly benefit statements provided to participants who direct their retirement plan investments must include a notice directing participants to a Department of Labor (DOL) website on individual investing and diversification (*http://www.dol.gov/ebsa/investing.html*). This website includes the DOL's brochure, A Look at 401(k) Plan Fees. Plan sponsors may wish to direct participants to this resource at other times, including at enrollment when they provide participants with initial information on plan investment options and fees. Plan sponsors will also likely want to continue to draw on investment education materials that they and their service providers develop. Given the extensive work by the private sector in the investment education area and the new prominence of the DOL's individual investing website as a result of the PPA requirement, we recommend that the DOL establish a formal and periodic process to seek private-sector input regarding the contents of its site.

Prepared Statement of Larry H. Goldbrum, Esq., General Counsel, the SPARK Institute

Chairman Miller, Ranking Member McKeon, honorable members of the Committee, my name is Larry Goldbrum and I am General Counsel of The SPARK Institute, an industry association that represents the interests of a broad based cross section of retirement plan service providers, including members that are banks, mutual fund companies, insurance companies, third party administrators and benefits consultants. It is an honor for me to share our organization's views on the proposed 401(k) Fair Disclosure for Retirement Security Act of 2007.

Although The SPARK Institute1 has publicly supported and promoted meaningful fee disclosure by employers, retirement plan service providers and investment providers, we are concerned about the unnecessarily burdensome and costly approach taken in the 401(k) Fair Disclosure for Retirement Security Act of 2007 (the "Bill"). We believe the Bill will ultimately serve to weaken, not strengthen, the defined contribution system. The Bill, as currently proposed, will discourage new plan formations, will significantly increase plan costs, will discourage employee participation and savings, and will create fertile ground for frivolous lawsuits brought by plaintiffs' lawyers primarily seeking settlements from perceived deep pockets.

Background

The disclosure provisions in the Bill require plan sponsors to make certain disclosures to plan participants and for plan service providers to make certain disclosures to plan sponsors. Earlier this year, the Department of Labor's ("DOL") issued a Request for Information ("RFI") regarding plan participant disclosures. Included in our response to the RFI, were guiding principles that we believe should be followed by legislators and regulators in developing any participant disclosure rules and regulations. The principles are:

1. Fee information is only one of many data points and arguably not the most important one that participants should consider in making investment decisions.
2. Over-emphasis on fees and expenses may lead to poor investment decisions, as well as lower employee participation and contributions to employer sponsored retirement plans.
3. Participant fee disclosure must be short and simple to have any chance of being effective.
4. Only information that is reasonably likely to be read and influence the investment decisions of otherwise passive participant investors in choosing among their plans' investment options should be included in any required disclosure.
5. Participants will ultimately bear the costs of any required disclosure and access to additional information.

Fee disclosure requirements should neither favor any one retirement plan or investment industry segment nor disrupt the current competitive balance among such service providers.

The following is a section-by-section analysis of our views regarding some of the more significant provisions of the Bill.

Plan Sponsor Fees and Conflicts Disclosures

A. General disclosure requirements

A plan may not enter into a contract involving compensation to a service provider of $1,000 or more unless the "plan administrator" receives advance written disclosure from the service provider of certain required information. The required disclosures include identification of who provides the services under the agreement, including affiliates and third parties. Additionally, the disclosures must include: (1) a description of the services, (2) an itemized list of the expected annual "cost" of each component of such services, and (3) information about amounts paid to affiliates and third parties. Sections 111(a)(1) & (9).

1. The SPARK Institute represents the interests of a broad based cross section of retirement plan service providers, including members that are banks, mutual fund companies, insurance companies, third party administrators and benefits consultants. Our members include most of the largest service providers in the retirement plan industry and our combined membership services more than 95% of all defined contribution plan participants.

2. Exiting regulations under ERISA Section 404(c), and the proposed qualified default investment alternative regulations are safe-harbors that plan sponsors are not obligated to comply with.

SPARK Institute Observations—We are concerned that these requirements obligate service providers to disclose proprietary information that will become readily available to their competitors. The proposal is extremely broad and would require

record keepers who subcontract out certain services that have nothing to do with participant investments to reveal the identity of their suppliers and the financial terms of their arrangements.

The proposal requires disclosure of the "cost" of the services. We presume that the reference is intended to mean the cost of such services to the plan or the participant, not the service provider's costs. We are concerned that the language in the proposal is susceptible to confusion and misinterpretation. Additionally, the requirement that the service provider provide an itemized breakdown of the costs of the underlying component services will be onerous for bundled service providers. The information required for such breakdowns is generally not available and requiring an itemized breakdown is contrary to the bundling concept.

Additionally, the proposal does not take into account the fact that generally neither the plan nor the plan sponsor enters into agreements with the mutual fund companies that manage the funds used by the plans. If the proposal were to require such agreements the disruption to plan sponsors, retirement plan service providers, and investment companies would be significant. The time and resources necessary to obtain such agreements would be staggering. Moreover, it would be unreasonable to require retirement plan record keepers to enter into such agreements and make the disclosures on behalf of the investment funds selected by a plan.

B. Required minimum disclosures—The proposal includes a long list of information that must be disclosed by all service providers. The list includes sales commissions, start-up fees, investment management expenses, investment advice expenses, estimated trading expenses, expenses for administration and record keeping, legal fees, trustee fees, termination or surrender charges, total asset-based fees, 12b-1 fees, and soft dollars. Section 111(a)(2)(A). Expense estimates can be used if the actual amounts are not known. However, estimates that are later discovered to be materially incorrect must be corrected as soon as practicable. Section 111(a)(2)(B).

SPARK Institute Observations—We are concerned that the required minimum disclosures create a rigid and inflexible list of information that plan sponsors must receive from every service provider they deal with. Without restating the reasons we provided in other documents, we note that a conceptual framework that allows service providers flexibility to customize disclosures for their products and services should be established instead of detailed lists of disclosures.

Additionally, we are concerned that the proposal requires plan specific dollar disclosures or estimates instead of expressly allowing for the requirements to be satisfied by using fee or rate disclosures. Dollar disclosures and estimates of certain fees that are driven by factors beyond the control of the service provider can be difficult to calculate. Such fees include, for example, loan origination, distribution, and participant investment advice fees. A calculation or estimate of any of such fees is dependant upon decisions made by participants that cannot always be predetermined. Additionally, dollar estimates of asset-based fees can vary significantly due to market fluctuation. Service providers will have to monitor their actual fees and compare them to their estimates on a regular basis in order to be able to make corrections required by the proposal. We are concerned that this entire process creates unnecessary additional work for plan sponsors and service providers when the same goal can be accomplished through simple rate disclosures.

C. Conflicts disclosure—The Bill requires detailed written disclosure regarding any potential conflicts that the service provider may have "due to [a] financial or personal relationship" that the service provider may have with the plan sponsor, the plan or other service providers, and for which the service provider receives payment for services. Such disclosure must include information about the use of the service provider's proprietary investment products and whether the service provider receives payments from third parties for making such third parties investment products available. Section 111(a)(3).

SPARK Institute Observations—We are concerned that the language of this provision is needlessly broad, potentially confusing and susceptible to misinterpretation. We are concerned about the references to "personal relationships" and conflicts with other service providers which appear to be unnecessary. We believe that a more appropriate provision would be to require service providers to disclose potential conflicts that they may have with the plan, plan sponsor and plan participants as a result of financial compensation they may receive from third parties in connection with the plans that they service.

D. Mutual fund share classes—Service providers must disclose that the "share prices" of certain mutual funds share classes may be different from the funds' retail share classes. The proposal appears to incorrectly refer to "share prices" instead of the expense ratio of the funds. Section 111(a)(4).

SPARK Institute Observations—Although we generally understand what we presume to be the point of this provision, i.e., to let plan sponsors know that there may

be other share classes offered by a fund, the specificity of the provision causes it to miss its objective. Many funds offer multiple non-retail classes of shares (e.g., trust and institutional shares) that may be available to retirement plans and cheaper than retail classes. We are concerned that the focus on retail shares will likely defeat the purpose of the provision. We also note that the focus of the proposal on retail shares suggests that the drafters appear to be operating under the incorrect assumption that the expense ratios of retail shares classes are generally lower than the expense ratios of share classes used by retirement plans. We are also concerned that the assumed underlying purpose of this provision only applies solely to mutual funds. We believe that a more appropriate approach would be to establish a general conceptual requirement that meets the intended objective.

E. "Free services"—The proposal requires that any service provider that provides services "without charge or for fees set at a discounted rate or subject to rebate" must disclose the extent to which and the amount such service provider is paid by others from participant accounts. Section 111(a)(5).

SPARK Institute Observations—We are concerned that this provision, which appears to be intended to force disclosure of potential conflicts of interest, is too broad, duplicative with other provisions of the proposal, potentially confusing and susceptible to misinterpretation. We note that other provisions in the proposal specifically require the disclosure of potential conflicts of interest. Service providers typically publish a "standard" price list for their services but generally discount such prices due to industry competition. The price lists are generally used for broad marketing purposes and during the very early sales stages (e.g., prospecting phase). Service providers generally do not publish or disclose publicly the actual fees that they are willing to accept for their services because that information is considered confidential and proprietary. Additionally, service providers' fees are frequently negotiated with the plan sponsor and change based on many factors, including for example, the plan's service needs and demographics. We are concerned that virtually every deal would be subject to the disclosure requirements of this provision merely because service providers generally charge less than the fees set forth in their standard publicly available fee schedules.

F. Model statements—The DOL is directed to issue a model statement for the foregoing disclosures. Section 111(a)(6).

SPARK Institute Observations—We are concerned that the DOL is being directed to accomplish the impossible. As we have stated before in other documents, a one size fits all disclosure form that is suitable for and acceptable to the various retirement plan services and investment providers, takes into account all of the products and investment structures, maintains the competitive balance in the affected industries, and is cost effect to produce will be virtually impossible to create. Although we recognize that service providers will not be required to use the model, we are concerned that some plan sponsors may demand it. Consequently, certain service providers may be competitively disadvantaged during the sales process.

G. Annual Disclosure—The written disclosure must be provided at least annually, and within 30 days of any material change. Section 111(a)(7).

SPARK Institute Observations—We are concerned that this requirement is needlessly burdensome. Service providers should not be required to produce the required plan specific dollar disclosures or estimates annually unless they materially change their rates or their compensation from third parties changes materially. We note that ERISA already limits a plan fiduciary's ability to unilaterally increase the compensation it receives from a plan. A more appropriate alternative may be that service providers should only be required to update their plan sponsor disclosures when there are material changes relating to (i) the amounts charged by the service provider to the plan sponsor, the plan or plan participants, or (ii) the compensation the service provider may receive from others, including third parties and the funds that are used by the plan.

H. Availability of required disclosures—The written disclosure statement must be made available to plan participants upon request, and must be posted on the plan sponsor's website or, we presume, by the service provider for the plan sponsor. Section 111(a)(8).

SPARK Institute Observations—We are concerned that the proposed disclosure requirements include proprietary and confidential information that service providers should not be forced to provide to plan participants. Given the specific plan participant disclosure requirements, the role of the plan sponsor, and the nature of the required plan sponsor disclosures, the information that is included in the plan sponsor disclosure statement is of little value to plan participants. Moreover, the information that will be included in such statement will be complex, will confuse the vast majority of participants, and will be subject to misinterpretation. Plan sponsors and service providers should not be put in a position of having to explain this informa-

tion to participants who have no control over the plan sponsor level decisions that such information is intended to facilitate. Moreover, by requiring such information to be provided to participants and posted on websites, the confidential and proprietary information included in such statements will easily become available to each service provider's competitors. Additionally, we are concerned that the confidential and proprietary information will become readily available to plaintiffs' lawyers and will create fertile ground for frivolous and costly lawsuits brought by such lawyers primarily seeking settlements from plan sponsors and service providers who are perceived to have deep pockets and who are concerned about their public reputations.

III. Participant Investments and Fees Disclosures

A. Advance notice of investment options—Generally, participant directed plans must provide a written notice to participants at least annually, no less than 15 days before each plan year, regarding the plan's investment options. Such notice must also be provided in advance of any change in investment options, or when an employee begins participation in the plan. Section 111(b)(1). The proposal includes a long and detailed list of information that must be included in the participant notice. Section 111(b)(2).

SPARK Institute Observations—We are concerned that these mandated detailed disclosures are inconsistent with the guiding principles that The SPARK Institute believes should be taken into account in connection with the development of any new rules and regulations relating to participant fee disclosure. Among the problems with the notice requirement are that the notice will overwhelm and confuse participants instead of enlightening them, and will be costly to produce and maintain.

B. Required information—The Bill requires the notice to include the following information regarding each investment option: name, investment objectives, level of risk, whether the option is a comprehensive solution, historical performance, historical fees, an explanation of the difference between asset-based and annual fees, comparative benchmark information, and how to get additional information. The notice must include a cautionary statement about relying too much on fees as the basis for investment decisions. Additionally, the notice must include a fee menu in an easy to understand format for the average participant. The fee menu must include such information that the DOL determines is necessary to allow participants to evaluate the services that may be provided in connection with the investment options and the fees that could be charged. Fees must be categorized among the following three categories: (i) fees that vary based on the investments selected by the participant (e.g., expense ratios), (ii) fees that vary based on the total assets in the participants account regardless of the investment option, and (iii) administration and transaction based fees (e.g., loan origination fees). The notice must also include a description of the purpose of each fee, including whether such fee is for investment management, commissions, administration or record keeping. The notice must include information about potential conflicts of interest that any person receiving fees may have. Sections 111(b)(2) & (3). Estimates can be used if the actual amounts are not known. Section 111(b)(5).

SPARK Institute Observations—We are concerned that these disclosure requirements are extremely and needlessly complex, and as noted above, the information is likely to confuse participants rather than enlighten them. Many of the concepts required to be disclosed cannot be explained in a short, easy to understand format that the average participant will understand. In order to preclude after the fact claims by plaintiffs' lawyers that such disclosures were not understandable or insufficient, most notices will become lengthy and detailed with technical disclosures intended to mitigate the risk of litigation. This will make the disclosures useless to the vast majority of participants.

The requirements do not take into account the fact that the list of information may not be available for or apply to non-mutual fund investment options (e.g., expense ratios for annuity products). Additionally, many plans offer plan specific asset allocation funds or portfolios to plan participants as investment options. Such plan specific portfolios are typically not mutual funds, but they may use mutual funds as their underlying investments. We are concerned that suitable benchmarks may not always be available for such portfolios. The list of required disclosures also excludes some information that should be provided, such as the identity of the type of security (e.g., mutual fund, annuity, etc.), the identity of the investment manager or guarantor (in the case of guaranteed products), and non-performance factors for insurance type products.

The purpose of the proposed expense categories is unclear, such categories will require fees to be disclosed in awkward ways, and will create confusion. For example, mutual fund expense ratios would be disclosed under category "i" because they vary

based on the investment selected, but redemption fees associated with a fund presumably would have to be disclosed under category "iii" because they are transaction based.

Plan sponsors and service providers should not be required to develop and provide specific disclosures of the underlying components of the investments fees (e.g., mutual fund expense ratio components) and the purpose of such fees. Such disclosure should be available upon request only and should be provided through materials otherwise available from a fund (e.g., profile prospectus or a full prospectus).

Plan sponsors should not be required to provide potential service provider conflict of interest disclosures to plan participants when such information has no direct impact on participant decisions. For example, a potential conflict of a broker that is properly disclosed to a plan sponsor should not have to be disclosed to participants who will never come in contact with such broker. In such cases the information will only create needless confusion and potential suspicion. However, if the potential conflict is that the broker's compensation may vary based on how participants invest their accounts and the broker may talk to participants about their plan investments, then such disclosure may be meaningful. However, such disclosure should be included in more appropriate documents (e.g., investment education materials used by the broker) instead of a mandated annual disclosure form.

C. Model notice—The DOL is directed to issue a model notice for the foregoing disclosures. Section 111(b)(4).

SPARK Institute Observations—We are concerned that the DOL is being directed to accomplish the impossible. As we have stated before in other documents, a one size fits all disclosure form that is suitable for and acceptable to the various retirement plan services and investment providers, takes into account all of the products and investment structures, maintains the competitive balance in the affected industries, and is cost effect to produce, will be virtually impossible to create. Although we recognize that service providers would not be required to use the model, we are concerned that some plan sponsors may demand it.

IV. Annual Participant Benefits Statement

A. In addition to providing the participant investment notice discussed above, participant directed plans would be required to provide an annual benefits statement that discloses very specific and detailed fee information. The statements would have to be provided within 90 days of the close of each plan year. Most of the required information, or similar information, is already provided on quarterly participant statements. However, the proposal requires detailed dollar disclosure of the fees charged against the participant's account for each investment, including the underlying investment fees (e.g., expense ratios and trading costs), loads, total asset-based fees (including variable annuity charges), mortality and expense charges, guaranteed investment contract fees, employer stock fees, directed brokerage charges, plan administration fees, participant transaction fees, total fees, and total fees as a percentage of current assets. Section 111(c)(2). The statement must compare the performance of the investment options to a nationally recognized market-based index. Estimates can be used if the actual amounts are not known. Section 111(c)(4).

SPARK Institute Observations—We are concerned that these requirements are in many respects extremely complex, and in certain other respects, duplicative to existing quarterly participant statement requirements. We are also concerned that providing this statement is impractical and will be expensive. Plans already provide quarterly participant statements. However, most record keeping systems are not designed to produce a single cumulative annual statement. Additionally, most systems are not currently able to gather, calculate and present the detailed fee information required under the proposal. Most of the information related to the fees of the underlying investments is embedded within the underlying investment funds. In the case of mutual funds, the information that plan sponsors would have to provide is simply not on the record keeping systems because such information by its very nature is embedded in the investment fund. It is not clear whether rate disclosures would be sufficient under the proposal when the participant level dollar disclosures are not readily available, even if they could be calculated at a cost. The detailed items that must be disclosed to participants will also have to be explained to them and will most likely confuse instead of enlighten. Concerns about potential litigation among plan sponsors and service providers will cause the statement content to expand, become complex and ultimately, be overwhelming for the average participant. In summary, the proposal will, if implemented, result in the creation of a statement that is more confusing than anything that plan participants currently receive or have access to regarding any of their investments.

Additionally, redesigning record keeping systems to produce the statements and complying with these requirements on an ongoing basis will be expensive. Such

costs will ultimately be borne by participants for little or no perceived benefit because, for the vast majority of participants, the information will either be ignored or will not motivate better participant saving and investment behavior.

B. The DOL is directed to issue a model notice for the foregoing disclosures. Section 111(c)(5).

SPARK Institute Observations—As we noted previously, we are concerned that the DOL is being directed to accomplish the impossible.

Other Disclosure Provisions

A. The disclosure requirements are not intended to limit or serve as a basis for any inference regarding a plan fiduciary's responsibility to discharge its duties with respect to the plan for the purpose of, among other things, defraying the reasonable expenses of administering the plan (see ERISA Section 404(a)(1)(A)(ii)). Section 111(d).

SPARK Institute Observations—As noted previously, we are concerned that these disclosure requirements will create fertile ground for frivolous and costly lawsuits brought by plaintiffs' lawyers primarily seeking settlements from plan sponsors and service providers who are perceived to have deep pockets and who are concerned about their public reputations.

B. The disclosure requirements of the Bill would be effective for plan years beginning after enactment.

SPARK Institute Observations—We are concerned that the service providers that will be expected to facilitate compliance with the plan sponsor and other disclosure requirements will need significantly more time to prepare for such requirements. For example, the system functionality that would be necessary in order to produce the annual participant statements does not exist today and will take a significant amount of time to develop. Additionally, we are concerned that the plan sponsor disclosure requirements will apply to existing service agreements. Service providers will be overwhelmed with having to provide customized plan specific disclosures for thousands, and for some providers, tens of thousands of plans that they service.

Index Fund Requirement

Participant directed plans must include at least one investment option which is a nationally recognized market-based index fund which offers a combination of returns, risk and fees that is likely to meet the retirement income needs at adequate levels of contributions. Section 402(c).

SPARK Institute Observations—We presume that the intent of this provision is to make "low cost" investment options available to plan participants. However, we are concerned about the potential misconception that requiring such options to be added will meet its objective. Requiring such funds to be added will not change the economics of servicing a plan. Regardless of which funds are used in any plan, plan service providers must have a source of revenue to get paid. If an index fund offers a class of shares that provides revenue sharing to unaffiliated plan service providers, such class will most likely be used when necessary to generate adequate revenue for the service providers. Service providers may choose to only offer funds that provide such adequate revenue. Alternatively, record keepers can assess additional asset-based charges to fund accounts to generate the necessary revenue. In both cases the plan sponsor and service provider can agree to fee arrangements that maintain the current revenue and economics of the plan. We note that plan sponsors will have the option, which they have today, to pay for most plan fees out of their own assets or impose such fees on plan participants. Consequently, mandating the use of index funds will not meet the presumed objectives and seems unnecessary.

Additionally, the requirement that the index fund is one that "offers a combination of returns, risk and fees that is likely to meet the retirement income needs at adequate levels of contributions" is too subjective. Reasonable investment experts are likely to disagree on which funds satisfy such requirements. The subjective nature of the requirement makes it untenable. Plan sponsors should not be required to select a fund based on such criteria. Additionally, we are concerned that these subjective requirements will inevitably expose plan sponsors to after the fact claims from plaintiffs' lawyers that the fund selected did not or will not generate enough income for participants.

Finally, we are unaware of any existing rules or regulations that require a plan to include a specific fund as an investment option.2 Index funds should not be mandated through legislation and given a Congressional "seal of approval" as an investment option. Additionally, we note that the index fund mandate will not change participant behavior. Participants who are not otherwise engaged in making investment decisions will not become engaged as a result of having this option available. Participants who are otherwise engaged and investment savvy will simply consider this

option among the others available to them and will evaluate it based on its merits, which will include many factors other than fees. However, plan sponsors should not be forced to include such funds in their plans. Instead, market forces and the suitability of such funds for use in plans should be allowed to drive plan sponsor decisions.

Advisory Council

The Bill would establish the Advisory Council on Improving Employer-Employee Retirement Practices. Section 519. The Council would have 12 members, half of whom will represent the interests of plan participants and the other half will represent employers.

SPARK Institute Observations—Setting aside whether or not such Council is necessary, beneficial or will be effective, we are concerned that the proposal does not include any representation from the retirement services and investment products industries. Long-term improvement to retirement plan and investment products ultimately requires the products, support and services from such industries. We believe that any council of this type would be more productive, effective, and benefit from the inclusion of appropriate industry experts.

Conclusion

Although The SPARK Institute supports and encourages greater fee transparency, we are concerned that the Bill will be unduly burdensome for plan sponsors and service providers. We believe that the proposal will impose significant additional burdens on plan sponsors, and create needless complication that could have a detrimental effect on the voluntary employer sponsored retirement plan system.

The required disclosures place too much emphasis on fees, will be lengthy, complex and intimidating for participants. Such disclosures will likely not be read and will not change the behavior of the vast majority of plan participants. The proposal also appears to rely on paper-based notices instead of promoting the use of the internet and other electronic means of disclosure.

Additionally, we are concerned that service providers' proprietary and confidential information will become readily available to their competition. The requirements will expose plan sponsors and service providers to new types of frivolous and costly lawsuits brought by plaintiffs' lawyers primarily seeking settlements from plan sponsors and service providers who are perceived to have deep pockets and who are concerned about their public reputations. Such requirements, among others of the Bill, will disrupt the competitive balance in the retirement plan and investment industries.

We are also concerned that the proposed rules are in certain respects duplicative with existing requirements under ERISA, and in certain other respects, may be inconsistent with requirements under rules and regulations of other regulatory agencies. Duplication and inconsistencies make compliance more complicated and costly for everyone involved.

The SPARK Institute believes that regulators, such as the DOL and Securities and Exchange Commission, should be permitted to address and resolve the perceived disclosure issues under existing law through their regulatory authority. If regulators believe that additional laws are needed in order to facilitate solving such concerns, then Congress should adopt legislation that fills the "gaps" identified by the regulators.

On behalf of The SPARK Institute, I thank the Committee for the opportunity to share our views on this important issue.

A Primer on Plan Fees and an Analysis of H.R. 3185, the 401(k) Fair Disclosure for Retirement Security Act of 2007

American Bankers Association; Committee on Investment of Employee Benefit Assets; the ERISA Industry Committee; the Financial Services Roundtable; Investment Adviser Association; Investment Company Institute; National Association of Manufacturers; Profit Sharing/401k Council of America; Securities Industry and Financial Markets Association; Society for Human Resource Management; United States Chamber of Commerce

ERISA provides many safeguards for the protection of workers' retirement assets. Plan assets must be held in a trust that is separate from the employer's assets. The fiduciary of the trust (normally the employer or committee within the employer) must operate the trust for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. In other words, the fiduciary has a duty under ERISA to ensure that any expenses of operating the plan, to the extent they are paid with plan assets, are reasonable.

Plan fees

As Congress examines retirement plan fees, it is critically important that policymakers have accurate information regarding such fees. The vast majority of participants in ERISA plans have access to capital markets at lower cost through their plans than the participants could obtain in the retail markets because of economies of scale and the fiduciary's role in selecting investments and monitoring fees. The level of fees paid among all ERISA plan participants will vary considerably, however, based on variables that include plan size (in dollars and/or number of participants), participant account balances, asset mix, and the types of investments and the level of services being provided. Below is data from surveys conducted by various organizations that monitor and analyze plan fees. The studies reflect, in particular, the impact of plan size and average account balances on fees:

CEM Benchmarking Inc.—CEM is a benchmarking company that serves 300 of the world's largest public and corporate pension plans in the US, Canada, Europe and Australia. A study of 88 US defined contribution plans with total assets of $512 billion (ranging from $4 million to over $10 billion per plan) and 8.3 million participants (ranging from fewer than 1,000 to over 100,000 per plan) found that total costs ranged from 6 to 154 basis points[1] (bps) of plan assets in 2005. Total costs varied with overall plan size. Plans with assets in excess of $10 billion averaged 28 bps while plans between $0.5 billion and $2.0 billion averaged 52 bps. Further, costs depended on the average account balance. Plans with an average account balance less than $55,000 paid four bps more in administrative compliance costs than plans with an average account balance exceeding $55,000. Total costs were also affected significantly by asset mix. Costs rose as the proportion of plan assets invested in domestic small cap stock and alternative investments (i.e., real estate) increased. In a separate analysis conducted for the Profit Sharing / 401k Council of America, CEM reported that, in 2005, its private sector corporate plans had total average costs of 33.4 bps and median costs of 29.8 bps.

HR Investment Consultants—HR Investment Consultants is a consulting firm providing a wide range of services to employers offering participant-directed retirement plans. It publishes the 401(k) Averages Book that contains plan fee benchmarking data. The 2007 edition of the book reveals that average total plan costs ranged from 159 bps for plans with 25 participants to 107 bps for plans with 5,000 participants.

Committee on Investment of Employee Benefit Assets (CIEBA)—CIEBA is the voice of the Association of Financial Professionals (AFP) on employee benefit plan asset management and investment issues. CIEBA represents more than 115 of the country's largest pension/retirement funds. Its members manage $1.4 trillion in defined benefit and defined contribution plan assets, on behalf of 16 million (defined benefit and defined contribution) plan participants and beneficiaries. A 2005 survey of 109 CIEBA members revealed that plan costs paid by defined contribution plan participants averaged 22 bps.

Department of Labor fee transparency initiatives

Fee disclosure and transparency present complex issues. Amending ERISA through legislation to prescribe specific fee disclosure will lock in disclosure standards built around today's practices and could discourage product and service innovation. The Department of Labor (DOL) has announced a series of regulatory initiatives that will make significant improvements to fee disclosure and transparency. The undersigned support the DOL's efforts. We believe that this is the best approach to enhance fee transparency in a measured and balanced manner and we urge Congress to delay taking legislative action until the Department of Labor has completed its work. The DOL's initiatives are as follows:

Annual Reporting Requirements—Among the new impending fee disclosure obligations are revised annual reporting requirements for plan sponsors. DOL is about to finalize modifications to the Form 5500 and the accompanying Schedule C, on which sponsors report compensation paid to plan service providers. The modifications will expand the number of service providers that must be listed and impose new requirements to report service provider revenue-sharing. The final regulations implementing the new Form 5500 are expected in the very near future and are expected to first be applicable to the 2009 plan year.

Service Provider Disclosure Obligations—DOL also intends later this year to issue a revised regulation under ERISA Section 408(b)(2), which is a statutory rule dictating that a plan may pay no more than reasonable compensation to plan service providers. The expected proposal is designed to ensure that plan fiduciaries have ac-

[1] One basis point is one-hundredth of one percent—100 basis points equals one percent.

cess to information about all forms and sources of compensation that service providers receive (including revenue-sharing). Both sponsors and providers will be subject to new legal requirements under these proposed rules, including an anticipated requirement that all third party compensation be disclosed in contracts or other service provider agreements with the plan sponsor.

Participant Disclosure Rules—The DOL's remaining initiative focuses on revamping participant-level disclosure of defined contribution plan fees. DOL issued a Request for Information ("RFI") in April 2007 seeking comment on the current state of fee disclosure, the existing legal requirements and possible new disclosure rules. Comments were filed by July 24, 2007. DOL has indicated that it intends to propose new participant disclosure rules early in 2008 that will likely apply to all participant-directed individual account retirement plans.

Principles for reform

We support regulatory reforms that reflect the following principles:

- Sponsors and Participants' Information Needs Are Markedly Different. Any new disclosure regime must recognize that plan sponsors (employers) and plan participants (employees) have markedly different disclosure needs.
- Overloading Participants with Unduly Detailed Information Can Be Counterproductive. Overly detailed and voluminous information may impair rather than enhance a participant's decision-making.
- New Disclosure Requirements Will Carry Costs for Participants and So Must Be Fully Justified. Participants will likely bear the costs of any new disclosure requirements so such new requirements must be justified in terms of providing a material benefit to plan participants' participation and investment decisions.
- Information About Fees Must Be Provided Along with Other Information Participants Need to Make Sound Investment Decisions. Participants need to know about fees and other costs associated with investing in the plan, but not in isolation. Fee information should appear in context with other key facts that participants should consider in making sound investment decisions. These facts include each plan investment option's historical performance, relative risks, investment objectives, and the identity of its adviser or manager.
- Disclosure Should Facilitate Comparison But Sponsors Need Flexibility Regarding Format. Disclosure should facilitate comparison among investment options, although employers should retain flexibility as to the appropriate format for workers.
- Participants Should Receive Information at Enrollment and Have Ongoing Access Annually. Participants should receive fee and other key investment option information at enrollment and be notified annually where they can find or how they can request updated information.

Analysis of H.R. 3185 (generally applicable to participant-directed individual account plans)

Disclosures to plan administrators Under H.R. 3185, plan service providers are required to provide a "service disclosure statement" that describes all plan fees, in twelve specific detailed categories, as a condition of entering into a contract. The proposal would also require that this information be broken down by each cost component or be "unbundled." The statement must describe the nature of any "conflicts of interests," the impact of mutual fund share class if other than "retail" shares are offered and if revenue sharing is used to pay for "free" services. Estimates are permitted only when actual amounts are not known. Service disclosure statements must be posted on the employer's intranet site and be provided to participants upon request.

The requirements of H.R. 3185 are duplicative with the existing fiduciary requirement that fees paid with plan assets be reasonable. The DOL's pending proposed regulatory changes under section 408(b)(2) likely will result in similar disclosures, provided at the same general point in time, as this new provision. Under the DOL's approach, the disclosures will be incorporated into fiduciary requirements regarding plan fees, making noncompliance a prohibited transaction.

The purpose of the requirement to "unbundle" all fees for all services is unclear. It is likely to be costly and is not likely to provide additional helpful information. Bundled service providers incorporate all services under a single price or several broad categories of prices. Plan administrators must ensure that the aggregate price of all services in a bundled arrangement is reasonable at the time the plan contracts for the services and that the aggregate price for those services continues to be reasonable over time. For example, asset-based fees should be monitored as plan assets grow to ensure that fee levels continue to be reasonable for services with relatively fixed costs such as plan administration and per-participant recordkeeping. The plan administrator should be fully informed of all the services included in a bundled ar-

rangement to make this assessment. Many plan administrators, particularly small employer plan administrators, may prefer reviewing costs in an aggregate manner and, as long as they are fully informed of the services being provided, they can compare and evaluate whether the overall fees are reasonable without being required to analyze each fee on an itemized basis. Imposing "unbundled" fee disclosure also raises significant concerns as to how a service provider would disclose component costs for services that are not offered outside a bundled contract. The posting of detailed unbundled services information could also force the public disclosure of proprietary information regarding contracts between service providers and plan sponsors.

The provision relating to "conflicts of interest" should be substantially revised. ERISA already prescribes strict rules for prohibited activities for service providers who are parties-in-interest or fiduciaries to a plan. While disclosure of conflicts is important, the provision goes much further by requiring the disclosure of relationships and affiliations between different providers, regardless of whether these relationships involve a conflict of interest. Plan sponsors are expected to be provided with considerably expanded disclosures in the near future as the result of the DOL initiatives (in all likelihood sooner than if new legislation is enacted). This additional information will be very helpful to plan sponsors in meeting their fiduciary requirements related to administering an ERISA-covered retirement plan.

The purpose of the share class disclosure requirement is not clear. Depending on the size of a plan and its service needs, participants may pay fees that are lower, higher, or the same as "retail" prices. There are myriad costs associated with administering a 401(k) plan that do not apply to individual ownership of a mutual fund and, for this reason, participants in some plans, particularly new small business plans, may pay additional costs. A comparison with an "institutional" share in this situation could result in an incorrect conclusion that the plan is paying more than reasonable expenses.

Disclosures to plan participants Under H.R. 3185, plan administrators must provide an advance notice of investment election information to participants and beneficiaries, generally 15 days prior to the beginning of the plan year. The notice must include the name of the option; investment objectives; risk level; whether the option is a "comprehensive investment designed to achieve long-term retirement security or should be combined with other options in order to achieve such security"; historical return and percentage fee assessment; explanation of differences between asset-based and other annual fees; benchmarking against a nationally recognized market-based index or other benchmark retirement plan investment; and where and how additional plan-specific and generally available investment information regarding the option can be obtained. The notice must include a statement explaining that investment selection should not be based solely on fees but on other factors such as risk and historical returns. The notice must include a fee menu of the potential service fees that could be assessed against the account in the plan year. Fees must be categorized as, 1) varying by investment option (including expense ratios, investment fees, redemption fees, surrender charges); 2) asset-based fees assessed regardless of investment option selected; and 3) administration and transaction fees, including plan loan fees, that are either automatically deducted each year or result from certain transactions. The fee menu shall include a general description of the purpose of each fee, i.e., investment management, commissions, administration, recordkeeping. The menu will also include disclosure of potential conflicts of interest that may exist with service providers or parties in interest, as directed by the Secretary of Labor.

Plan administrators must also provide an annual benefit statement that includes starting balance; vesting status; contributions by employer and employee during the plan year; earnings during the plan year; fees assessed in the plan year; ending balance; asset allocation by investment option, including current balance, annual change, net return as an amount and a percentage; service fees charged in the year for each investment, including, separately, investment fees (expense ratios and trading costs), load fees, total asset based fees (including variable annuity charges), mortality and expense charges, guaranteed investment contract (GIC) fees, employer stock fees, directed brokerage charges, administrative fees, participant transaction fees, total fees, and total fees as a percent of current assets; and the annual performance of the investment options selected by the participant as compared to a nationally recognized market based index

The new disclosure requirements that would be imposed by H.R. 3185 are overly complex and costly. We support disclosure of relevant fee information about the plan, but flexibility should be provided to ensure that the plan administrator can tailor the disclosure to meet the needs of plan participants. The participant disclosure requirements as presently drafted will likely result in lengthy "legalese" docu-

ments that would confuse most participants and possibly hinder rather than help them make investment decisions. The scope and detail of the disclosure might well result in a document that, at best, is ignored and, at worst, deters participation in the plan.

We agree that fee information should not be provided in a vacuum. Some of the required data elements and comparisons in the legislation use confusing terminology, have overlapping requirements, or are excessively detailed. For example, a "benchmark retirement plan investment" does not currently exist and no single benchmark is appropriate for every kind of investment. In many cases the required participant disclosure item would apply to some products and not others, and could be difficult to calculate, especially by the plan administrator.

Recordkeeping systems are not currently able to meet all the requirements of the annual benefit statement in H.R. 3185. Additional costs to participants will result from the significant system changes needed to comply and simpler disclosure would provide much of the same benefits to participants. Much of the required data about the plan and the participant's account is already required to be disclosed in the new benefit statement mandated under the Pension Protection Act, yet there is no coordination of the two requirements.

Minimum investment option requirement—Plans must include at least one investment option which is a nationally recognized market-based index fund that, as determined by the DOL, offers a combination of historical returns, risks, and fees that is likely to meet retirement income needs at adequate levels of contribution.

Plans should not be required to include a particular investment (with resulting fiduciary liability if the investment is found not to meet statutory and regulatory requirements). The provision would override a plan's ability to select and monitor plan investments by reaching a values conclusion that this investment is appropriate for all plans. It sets a precedent for further mandates regarding the investment of plan assets which is counter to ERISA's focus on a prudent process and would preempt the judgment of investment professionals. It is unlikely that any one "market-based index" alone is "* * * likely to meet retirement income needs." Further, embedding a particular investment option in law may lead participants to believe that this is either the "best" option or the government-sanctioned option, thereby steering plan participants into the investment which may not be appropriate for the individual participant.

Prepared Statement of the Investment Company Institute[1]

Hearing on "H.R. 3185, the 401(k) Fair Disclosure for Retirement Security Act of 2007" Committee on Education and Labor U.S. House of Representatives October 4, 2007

The Investment Company Institute1 welcomes the interest of Chairman Miller and the House Education and Labor Committee in enhancing disclosure in 401(k) plans and appreciates the opportunity to provide its views in connection with this hearing on H.R. 3185, the "401(k) Fair Disclosure for Retirement Security Act of 2007." The Institute has long supported effective disclosure to participants in individual account plans and the employers who sponsor those plans.[2] Mutual funds currently provide the most complete disclosure of any investment product available in 401(k) plans and the Institute has extensively studied what information is useful to and used by investors.

Chairman Miller has been open in soliciting comments on H.R. 3185 and we value the opportunity to offer constructive input as the Committee explores these issues.

The defined contribution system of 401(k) and similar plans has been a huge success. As of 2006, Americans have saved $4.1 trillion in private defined contribution plans, and another $4.2 trillion in IRAs. (Estimates suggest about half of all IRA assets originate from 401(k) and other employer plans.) Around half of all of the assets in defined contribution plans and IRAs are invested in mutual funds.[3]

Collaborative research between the Employee Benefit Research Institute (EBRI) and the Institute demonstrates that participants generally make sensible choices in allocating their investments[4] and that a full career with 401(k) plans produces adequate replacement rates at retirement.[5] Institute research also suggests that plan participants and plan sponsors are cost conscious when selecting mutual funds for their 401(k) plans. On an asset-weighted basis (that is, taking into account where 401(k) participants concentrate their assets), the average asset-weighted expense ratio for 401(k) stock mutual fund investors was 0.74%, half of the simple average stock mutual fund expense ratio in 2006 (1.50%).[6]

The biggest challenge in ensuring adequate retirement security for all Americans lies in encouraging workers to contribute and encouraging employers to offer a

workplace plan. Disclosure reform should seek to improve the 401(k) system without imposing burdens, costs and liabilities that deter employers from offering plans. For these reasons, we urge the Committee to proceed carefully as it considers specific changes to the 401(k) disclosure regime.

Initiatives to strengthen the 401(k) disclosure regime should focus on the decisions that plan participants and sponsors must make and the information they need to make those decisions. The purposes behind fee disclosure to plan sponsors and participants differ. Participants have only two decisions to make: whether to contribute to the plan (and at what level) and how to allocate their account among the investment options the plan sponsor has selected. Disclosure should help participants make those decisions. Voluminous and detailed information about plan fees could overwhelm the average participant and could result in some employees deciding not to participate in the plan. On the other hand, plan sponsors, as fiduciaries, must consider additional factors in hiring and supervising plan service providers and selecting plan investment options. Information to plan sponsors should be designed to meet their needs effectively.

Comments on H.R. 3185

- Disclosure to plan sponsors should provide information that allows them to fulfill their fiduciary responsibilities.

ERISA requires that plan fiduciaries act prudently and solely in the interest of plans and participants. Plan assets can only be used for the exclusive purpose of providing benefits and defraying reasonable expenses of administering plans. ERISA's prohibited transaction rules require that a contract with a service provider be for necessary services and provide only reasonable compensation. The Institute has consistently supported efforts to ensure that plan sponsors have the information they need as fiduciaries to select and monitor service providers and review the reasonableness of plan fees.[7] The Institute's views on disclosure to plan sponsors are set out in greater detail in the attached testimony we recently presented to the ERISA Advisory Council.

H.R. 3185 would require plan sponsors to obtain very detailed fee and financial relationship information from plan service providers. We recommend instead that the requirements be streamlined. In our view, plan sponsors should obtain information from service providers on the services that will be delivered, the fees that will be charged, and whether and to what extent the service provider receives compensation from other parties in connection with providing services to the plan. These payments from other parties, commonly called "revenue sharing," often are used in bundled and unbundled service arrangements to defray the expenses of plan administration.

We also recommend that a service provider that offers a number of services in a package be required to identify each of the services and total cost but not to break out separately the fee for each of the components of the package. If the service provider does not offer the services separately, requiring the provider to assign a price to the component services will produce artificial prices that are not meaningful. In today's competitive 401(k) market, bundled and unbundled providers compete effectively for plan business. This healthy competition has helped spur innovation in 401(k) products and services, such as new education and advice programs and target date funds. Forcing a 401(k) provider to quote separate prices for component services would constitute an inappropriate decision by policymakers to favor one business model over another. So long as plan fiduciaries can compare the total cost of recordkeeping and investments of a bundled provider with the total costs of recordkeeping and investments of an unbundled provider, they have the relevant information to discharge their fiduciary obligations.

The Institute supports disclosure of revenue sharing by requiring that a service provider disclose to plan sponsors information about compensation it receives from other parties in connection with providing services to the plan. This information will allow the plan sponsor to understand the total compensation a service provider receives under the arrangement. It also will bring to light any potential conflicts of interest associated with revenue sharing payments, for example, where a plan consultant receives compensation from a plan recordkeeper.

Allocations among affiliated service providers are not revenue sharing. When services are provided by affiliates of the service provider, a plan sponsor should understand all the services that will be provided and the aggregate compensation for those services. The service provider should not be required to disclose how payments are allocated within the organization. These allocations are not market transactions and any pricing of these transactions will be artificial, and, thus, of little value. Disclosure of allocations within a firm will not inform the plan sponsor of additional

compensation retained by the firm and will not inform the plan sponsor of a potential conflict that is not already apparent given the affiliation of the entities.

• Disclosure to plan participants should be simple and focused on key information.

Participants should receive the following key pieces of information for each investment product offered under the plan:

• Types of securities held and investment objective of the product
• Principal risks associated with investing in the product
• Annual fees and expenses expressed in a ratio or fee table
• Historical performance
• Investment adviser that manages the product's investments

This list is informed by research on what information investors actually consider before purchasing mutual fund shares.[8] The research also found that investors find a summary of information more helpful than a detailed document. This basic information should be provided on all investment options available under the plan, regardless of type.[9] The need for cost-effective, simple disclosure focusing on the key information participants need to make informed choices enjoys broad support, as reflected in the attached joint recommendation by 12 trade associations to the Department of Labor.[10]

ERISA disclosure rules should encourage and facilitate electronic delivery of investment information to participants. Plans should be allowed to provide online disclosure for every investment option for those employees who have reasonable access to the Internet.

Fees and expenses are only one piece of necessary information. While the fees associated with a plan's investment options are an important factor participants should consider in making investment decisions, no participant should decide whether to contribute to a plan or allocate his or her account based solely on fees. In many plans the lowest fee option is a money market fund or other low-risk investment because these funds are the least costly to manage. It is not appropriate for most participants to invest solely in these relatively lower return options.[11]

H.R. 3185 would require extensive disclosure to participants at enrollment and in annual statements. We do not believe this type of extensive disclosure is effective. Instead, participant disclosure should be short and concise and focused on the key information, described above, that participants need to make informed decisions in allocating their accounts. This is the approach the SEC is taking in developing a new streamlined disclosure document for mutual funds that easily could be adapted for all 401(k) investment products.[12]

The SEC's experience in developing mutual fund disclosure requirements is relevant also with respect to two other matters covered in H.R. 3185. First, H.R. 3185 would require the disclosure to sponsors and participants of the trading costs of a mutual fund or other collective fund used as a 401(k) plan investment. The SEC has repeatedly examined how best to disclose a mutual fund's "trading costs"[13] and has determined that the fund's turnover ratio is the best proxy for the trading costs of the fund. The turnover ratio can be easily calculated by funds, is easily understood by investors and is readily comparable among funds. It is expected that the SEC will include the fund portfolio turnover ratio as a prominent element of the new mutual fund profile it is developing. We recommend that any ERISA requirement to provide information to plan participants or sponsors about trading costs of pooled accounts use the portfolio turnover ratio as the appropriate proxy.

Second, H.R. 3185 would require that plans translate asset-based fees of plan investments into dollar amounts. The SEC concluded in 2004 that the most comparable and cost-effective way to give shareholders an understanding, in dollar terms, of the implications of asset-based fees on their account was to require a fee example in shareholder reports showing the fee paid on each $1,000 invested.[14] More complex dollar disclosures simply impose unnecessary costs and would not facilitate comparability. In 401(k) plans these costs would generally be borne by participants. We recommend that any ERISA requirement to provide participants with disclosure about the impact of fees on their accounts use a similar hypothetical example.

• Congress should not mandate a 401(k) plan's investment line-up.

H.R. 3185 would require a 401(k) plan to offer an index fund meeting requirements specified in the bill. The Institute is concerned with mandating in federal law that 401(k) plans offer a particular type of investment option. Congress should not substitute its judgment for investment experts and mandate investment choices properly reserved to plan sponsors as fiduciaries. It also should not endorse one type of investment strategy (indexing) over another (active management). This represents a significant departure from the basic fiduciary structure of ERISA and the Institute is concerned about the precedent this provision would set.

The mutual fund industry is committed to meaningful 401(k) disclosure, which is critical to ensuring secure retirements for the millions of Americans that use defined contribution plans. We thank the Committee for the opportunity to submit this statement and look forward to the opportunity for continued dialogue with the Committee and its staff.

ATTACHMENTS

- Institute Policy Statement on Retirement Plan Disclosure (January 30, 2007)
- Institute Statement to ERISA Advisory Council (September 20, 2007)
- Joint Trade Association Recommendations on Fee and Expense Disclosures to Participants in Individual Account Plans (July 24, 2007)
- Institute Comment Letter to Department of Labor on Fee Disclosure RFI (July 20, 2007)

ENDNOTES

[1] Institute members include 8,889 open-end investment companies (mutual funds), 675 closed-end investment companies, 471 exchange-traded funds, and 4 sponsors of unit investment trusts. Mutual fund members of the Institute have total assets of approximately $11.339 trillion (representing 98 percent of all assets of US mutual funds); these funds serve approximately 93.9 million shareholders in more than 53.8 million households.

[2] Attached to the testimony is a Policy Statement on Retirement Plan Disclosure adopted by the Institute Board of Governors in January 2007 that reaffirms and chronicles the Institute's long record in support of better disclosure.

[3] Brady and Holden, The U.S. Retirement Market, 2006, ICI Fundamentals, vol. 16, no. 3 (July 2007), available at *http://www.ici.org/pdf/fm-v16n3.pdf.*

[4] For example, in 2006, participants in their 20s allocated 59.7% of their accounts to pooled equity investments and company stock, and only 18.4% to GICs and other fixed-income investments. Participants in their 60s allocated 35.6% to GICs and other fixed-income investments. See Holden, VanDerhei, Alonso, and Copeland, 401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2006, ICI Perspective, vol. 13, no. 1, and EBRI Issue Brief, Investment Company Institute and Employee Benefit Research Institute, August 2007, available at *http://www.ici.org/pdf/per13-01.pdf.* The 2006 EBRI/ICI database contains 53,931 401(k) plans with $1.228 trillion in assets and 20.0 million participants.

[5] See Holden and VanDerhei, Can 401(k) Accumulations Generate Significant Income for Future Retirees? and The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement, ICI Perspective and EBRI Issue Brief, Investment Company Institute and Employee Benefit Research Institute, November 2002 and July 2005, respectively, available at *http://www.ici.org/pdf/per08-03.pdf* and *http://www.ici.org/pdf/per11-02.pdf,* respectively.

[6] Holden and Hadley, The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2006, ICI Fundamentals, vol. 16, no. 4 (September 2007), available at *http://www.ici.org/pdf/fm-v16n4.pdf.*

[7] For example, see Statement of the Investment Company Institute on Disclosure to Plan Sponsors and Participants Before the ERISA Advisory Council Working Groups on Disclosure (September 21, 2004), available at *http://www.ici.org/statements/tmny/04—dol—krentzman—tmny.html.*

[8] See Understanding Investor Preferences for Mutual Fund Information, Investment Company Institute (2006), available at *http://www.ici.org/pdf/rpt—06—inv—prefs—full.pdf.*

[9] As described in more detail in the attached Institute comment letter to the Department of Labor, disclosure of this information is appropriate for mutual funds, insurance separate accounts, bank collective trusts, and separately managed accounts. The same key pieces of information are relevant and should be disclosed for fixed-return products, where a bank or insurance company promises to pay a stated rate of return. In describing fees and expenses of these products, for example, the disclosure should explain that the cost of the product is built into the stated rate of return because the insurance company or bank covers its expenses and profit margin by any returns it generates on the participant's investment in excess of the guaranteed rate of return. In describing principal risks of these products, the summary should explain that the risks associated with the guaranteed rate of return include the risks of interest rate changes, the long-term risk of inflation, and the risks associated with the product provider's insolvency.

[10] Also attached is the Institute's comment letter to the Department of Labor regarding improvements to participant disclosure.

[11] In 2006, the asset-weighted average total mutual fund expense ratio for money market funds held in 401(k) plans was 0.43%, compared with 0.56% for bond mutual funds and 0.74% for stock mutual funds. See Holden and Hadley, supra note 6. In plans offering investment in employer stock, the employer stock option fund may be the lowest fee option because essentially no active investment management is involved, but it also would not be appropriate for participants to invest solely in one security. This point is made in the Department of Labor's publication for participants, Taking the Mystery Out of Retirement Planning, page 11, available at *http://www.dol.gov/ebsa/publications/NRTOC.html.*

[12] See Statement of the Securities and Exchange Commission Before the House Financial Services Committee (June 26, 2007), available at *http://www.house.gov/apps/list/hearing/financialsvcs—dem/sec—testimony—(6-2607).pdf.*

[13] The trading costs of a pooled investment product such as a mutual fund, collective trust, or insurance company separate account include not only brokerage commissions, but also costs

that cannot be quantified or expressed with accuracy, including bid-ask spreads and "market impact" costs.

[14] See Securities and Exchange Commission, Final Rule, Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies, 69 Fed. Reg. 11244 (March 9, 2004).

[Internet address to Investment Company Institute (ICI) Fee Disclosure RFI to U.S. Department of Labor, dated July 20, 2007, follows:]

http://www.ici.org/statements/cmltr/arc-ret/07—dol—fee—disclose—com.html

ICI Policy Statement — Retirement Plan Disclosure

Adopted by ICI's Board of Governors, January 30, 2007

In 2005, there were 47 million active participants in 401(k) plans, with their retirement savings invested not only in mutual funds but also a wide range of other investment products. As 401(k) plans assume increasing importance for future retirees, plan sponsors must be able to make the right choices in setting up their plans and participants must have the information necessary to make informed investment decisions. To that end, the Institute urges that the Department of Labor clarify the requirements for disclosure of the fees and expenses associated with 401(k) plans to assist plan sponsors in making meaningful comparisons of products and service providers. Similarly, we support action by the Department of Labor to require straightforward descriptions of all the investment options available to participants in self-directed plans. To achieve these important goals:

• The Department of Labor should require clear disclosure to employers that highlights the most pertinent information, including total plan costs.

We believe required disclosure to employers should focus on the total fees paid by the plan to a service provider (in the form of a percentage or ratio) and how expenses are allocated between the sponsor and participants. Required disclosure also should address the various categories of expenses associated with a plan, including arrangements where a service provider receives some share of its revenue from a third party. Under ERISA, the obligation to provide this information should rest with those parties having a direct relationship with the employer.

The Investment Company Institute (ICI) is the national association of the U.S. mutual fund industry, which manages more than half of 401(k) assets and advocates policies to make retirement savings more effective and secure.

In the late 1990s, the Institute, in cooperation with other private-sector organizations, created a Model 401(k) Plan Fee Disclosure Form, which is posted on the Department of Labor website. More recently, the Institute also helped develop a list of service- and fee-related items that plan sponsors should discuss with potential providers. These tools serve to identify what services will be provided for the fees charged, show all forms of expenses, and help employers make meaningful comparisons among the products and services offered to the plan. The tools also can be useful to the Department in crafting regulations and other guidance.

• The Department of Labor should require that participants in all self-directed plans receive simple, straightforward explanations about each of the investment options available to them, including information on fees and expenses.

In making investment elections under a plan, individuals should receive information on:

• investment objectives,
• principal risks,
• annual fees (expressed in a ratio or fee table),
• historical performance, and
• the investment adviser that manages the product's investments.

The Department should expand the current disclosure requirements to require plan administrators to provide participants with a concise summary of these ?ve key pieces of information for each investment option. One effective way to deliver this information is through email and other forms of electronic communication. Additional information, such as how fees and expenses are allocated among service providers, should be made available to participants (for example, posted on the Internet).

Such disclosure requirements would ?ll gaps in the information currently required to be provided to participants. The existing disclosure regime does not cover all plans in which participants make investment decisions for their accounts. For plans

that are covered, participants must receive full information about mutual funds, in the form of the fund prospectus. For other products, important information—such as operating expenses and historical performance—is available only on request. We support revising current rules to require a summary document for all self-directed plans that provides, for each investment product, the type of information that investors value and use. This information will empower participants in self-directed plans to manage their accounts effectively.

The mutual fund industry is committed to meaningful disclosure. Over the past 30 years, the Institute has supported efforts to improve the quality of information provided to plans and participants and the way in which that information is presented. Meaningful disclosure is critical to ensuring secure retirements for millions of Americans.

APPENDIX

ICI's Record: 30 Years of Advocating Better Disclosure

The Institute has long acted both in conjunction with other organizations and on its own to enhance the ability of employers to make appropriate choices for their plans. The Institute also has consistently called for effective disclosure to plan participants about investment options. This appendix describes the Institute's efforts over time to improve disclosure for both plan sponsors and participants.

Disclosure to Participants

For more than 30 years, the Institute has provided speci?c recommendations to the Department of Labor on the disclosure participants in self-directed plans should receive about investment options. Through letters and testimony before the Department and the ERISA Advisory Council, we recommended regulatory measures to ensure that participants and bene?ciaries receive adequate information on which to base their investment decisions.

- In a 1976 letter to the Department, the Institute advocated that when an individual becomes a participant, he or she should receive complete, up-to-date information about plan investment options, and, thereafter, regular and current information as to his or her investments.
- In 1987, the Institute recommended that under then-proposed 404(c) regulations, participants should receive the kind of information included in a mutual fund prospectus or Statement of Additional Information for all investment options—not just investment options subject to federal securities laws. We repeated this suggestion in 2001 to the Department and in testimony in 2004 and 2006 before the ERISA Advisory Council.
- In 1992, the Institute recommended that where a 404(c) plan has a limited number of investment alternatives, plan ?duciaries should be required to provide suf?cient investment information about each option up front. We urged the Department to specify the investment information that would be deemed sufficient, including information on fees and expenses and investment objectives.
- In testimony before the Department in 1997, the Institute asked the Department to address gaps in the disclosure regime, especially disclosure of administrative fees charged to participant accounts and information on annual operating expenses, which, for non-mutual fund investment vehicles, are required to be provided only upon request.
- In 1999, the Institute urged the Department to expand the scope of its proposed rules on electronic delivery to cover a broader range of disclosures and recipients.
- In testimony before the ERISA Advisory Council in 2004 and 2006, the Institute called for participants to receive clear and concise summaries of each investment option, including the product's investment objective, principal risks, fee/expense ratio (in the form of a fee table), and information about the investment adviser. In 2006, we added historical performance to the list. In the 2006 testimony, we also urged that this disclosure regime should apply to all self-directed plans—not just 404(c) plans—and that the Department update and expand its electronic disclosure rule in light of the increasing role of the Internet.

Disclosure to Plan Sponsors

The Institute likewise has consistently advocated clear rules for disclosure to plan sponsors and has developed various tools for use by sponsors and service providers.

- In 1999, the Institute published a Uniform 401(k) Plan Fee Disclosure Form, developed jointly with the American Bankers Association (ABA) and American Council of Life Insurance (ACLI). The form, which the Department posted on its website, is designed to help employers identify and monitor 401(k) plan fees and expenses and compare the fees and services of different providers.

• In testimony before the ERISA Advisory Council in 2004, the Institute called for clear, meaningful, and effective disclosure to plan sponsors. We recommended that plan sponsors be required to obtain complete information about investment options before adding them to the plan menu and obtain information concerning arrangements where a service provider receives some share of its revenue from a third party. The Institute offered to organize a task force to assist the Department in developing a disclosure regime for these compensation arrangements.

• In 2005, the Institute published a Model Disclosure Schedule for Plan Sponsors that might be used to disclose information on receipt by service providers of revenue from unaf?liated parties in connection with services to a plan. The Institute began discussions with other trade associations on developing an appropriate disclosure regime.

• In 2006, the Institute published a 401(k) plan fee and expense reference tool, developed jointly with the ACLI, ABA, Securities Industry Association, and American Benefits Council. The tool is a list of fee and expense data elements that plan sponsors and service providers may want to discuss when entering into service arrangements. We have asked the Department to post the tool on its website.

Statement of the Investment Company Institute

ERISA Advisory Council
Working Group on Fiduciary Responsibilities and Revenue Sharing Practices

Mary Podesta
Senior Counsel – Pension Regulation

September 20, 2007

The Investment Company Institute[1] is pleased to provide its views to the ERISA Advisory Council as it considers fiduciary responsibilities and revenue sharing practices. This is the third time in four years that we have testified to the Council on improving the ERISA regulatory regime in the interests of plan participants.

November of last year was the 25th anniversary of the birth of the 401(k) plan.[2] The Institute marked the occasion with a research retrospective that demonstrates that the 401(k) plan is a success story for Americans' retirement security.[3] As of year-end 2006, 401(k) plans held $2.7 trillion in assets, an amount greater than that held by private defined benefit plans.[4] And this does not count assets that have been rolled over into IRAs. Estimates suggest about half of the $4.2 trillion in IRAs in 2006 came from 401(k) and other employer plans. The number of 401(k) plans grew from fewer than 30,000 in 1985 to around 450,000 in 2006.[5]

Our research also shows that the assets of 401(k) plans are being effectively deployed to accumulate retirement wealth. Collaborative research by the ICI and the Employee Benefit Research Institute (EBRI) demonstrates that participants generally make sensible choices in allocating their investments[6] and that a full career with a 401(k) plan can produce adequate replacement rates at retirement.[7]

Plan fiduciaries play an essential role in assuring that workers can rely with confidence on 401(k) plans for retirement saving. Although 401(k) participants make their own investment decisions in most plans today, fiduciaries are charged with selecting an appropriate investment menu and entering into reasonable arrangements for the provision of administrative services to the plan. Often, plans contract to receive access to plan investment options and administrative services in a full service, or "bundled," arrangement in which a service provider offers the entire range of administrative services.

ERISA imposes clear responsibilities on fiduciaries in entering into any service arrangements. Under ERISA section 404(a), the fiduciary must act prudently and for the exclusive purpose of providing benefits and defraying the "reasonable" expenses of administering the plan. Under section 408(b)(2), fiduciaries must ensure that a service

contract is a reasonable arrangement for necessary services and that "no more than reasonable compensation is paid therefor." If a service arrangement does not meet these standards, section 4975(d)(2) of the Internal Revenue Code imposes an excise tax against the service provider.

As we testified in 2004,[8] effective disclosure by service providers to plan sponsors is essential to enabling plan fiduciaries to enter into and maintain reasonable 401(k) service arrangements. The purpose of disclosure should be to allow plan fiduciaries to compare service options and monitor arrangements over time. The Institute has called upon the Department of Labor to require plan fiduciaries to obtain information from service providers on the services that will be delivered, the charges the plan will incur, and the extent to which service providers receive compensation from others in connection with providing services to the plan. To assist plan fiduciaries in entering into service arrangements, the Institute and others created a disclosure tool, discussed in more detail below.

The Institute's testimony today focuses on why plans may choose to obtain both investment and administrative services through a single service provider and how to meet a plan sponsor's need for information in entering into and monitoring these service arrangements.

401(k) Service Arrangements

Use of bundled arrangements and asset-based fees

While a wide variety of practices exist, many plans contract with a recordkeeper to receive both administrative services and access to an array of investment products from which plan fiduciaries construct the menu of investments offered. The recordkeeper is compensated for its services to the plan, in whole or in part, by asset-based fees (such as sub-transfer agency or distribution fees) paid in connection with the plan's investment choices. These payments to recordkeepers from investment providers commonly are called "revenue sharing." Using a single full service provider eliminates the cost to a plan sponsor of dealing with and monitoring multiple providers, and provides a single responsible party for all aspects of the arrangement. A recent survey by Deloitte Consulting and others found that 75% of plan sponsors used a bundled arrangement.[9]

Using asset-based fees of plan investment options to defray the cost of recordkeeping and other plan administrative costs does not violate ERISA so long as a fiduciary does not use its discretion to cause itself to receive revenue sharing.[10] ERISA does not require flat charges for recordkeeping services. As the Department stated in testimony to the Working Group on July 11, "many of these arrangements may serve to reduce overall plan costs and provide plans with services and benefits not otherwise affordable."

Using asset-based fees to cover administrative services also effectively spreads the costs of acquiring necessary services over a shareholder or participant base. All mutual fund investors,

whether in a 401(k) plan, IRA, or taxable account, experience "mutualization." Some costs of administering a mutual fund shareholder's account are relatively fixed, such as the costs of printing prospectuses and sending shareholder statements. Because mutual funds charge asset-based fees, shareholders with larger investments subsidize smaller accounts. Similarly, wrap fees in brokerage accounts and M&E charges in insurance products mutualize certain costs in those products.

Under the Internal Revenue Code, a 401(k) plan and its services must be available to employees on a nondiscriminatory basis. Asset-based fees allow new participants and those with lower wages or smaller accounts to participate in plans without the cost of administration falling disproportionately, as a percentage of account balance, on them.

Asset-based fee arrangements also help pay for start-up or service provider transition costs. Service providers experience significant start-up expenses in servicing a newly created plan or beginning a client relationship with an existing plan that is moving from a previous provider. To avoid the plan incurring all those expenses in the first year, asset-based fees allow the provider to recoup its expenses over several years as assets grow. Absent these arrangements, employers would be less willing to establish new plans or switch service providers.

Monitoring and reviewing services and fees over time

Plan fiduciaries should monitor and review plan service arrangements from time to time to assure that they remain reasonable arrangements. In a bundled services arrangement where a plan recordkeeper receives asset-based compensation to defray the cost of recordkeeping, one aspect of the review will involve looking at the level of fees if the plan and participant accounts grow in size.

If the growth of plan assets supports a revision of the arrangement, the plan fiduciary and service provider have a number of options. One is to lower total plan costs by replacing existing plan investments with lower-cost options or share classes. Another is to provide the plan and participants with additional services that were not originally affordable. For example, as a new plan grows, it may become possible to provide participants with access to investment advice. A third option for plan fiduciaries might be to negotiate with the recordkeeper to share some of the recordkeeper's revenue with the plan.[11] Finally, the plan fiduciary can put the service contract out for bid to determine whether other service providers might offer comparable services at a lower cost. According to one recent study, plan sponsors, on average, evaluate their recordkeeper about every four years.[12]

Mutual funds in 401(k) plans

Of the $2.7 trillion in 401(k) assets at year-end 2006, $1.5 trillion, or about 55%, are invested in mutual funds. As a percentage of total 401(k) assets, mutual fund investment has

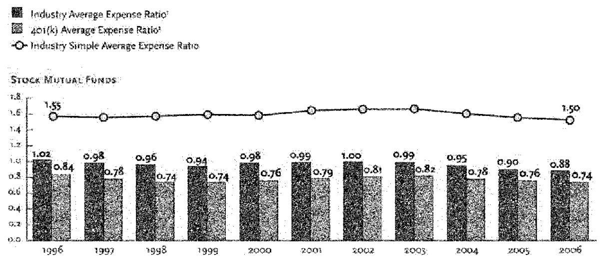
increased significantly. In 1994 only about 27% of 401(k) assets were invested in mutual funds.[13]

Institute research suggests that plan fiduciaries are cost conscious when selecting mutual funds for their 401(k) plans. Attached to this testimony is just-released research on the fees incurred by mutual fund investors in 401(k) plans. This research updates, with 2006 data, research we released last year, which married for the first time our extensive research on trends in mutual fund fees with our tracking of 401(k) plan holdings of mutual funds. Our research studies mutual fund fees in 401(k) plans because comparable information for other products offered in 401(k) plans is not readily available.[14]

In the competitive mutual fund market, 401(k) savers tend to concentrate their assets in low-cost funds. In 2006, the average stock mutual fund had an expense ratio of 1.50%. This is the simple average that does not reflect investment concentration: 77% of stock mutual fund assets in 401(k) plans were invested in funds with a total expense ratio of less than 1.00%. On an asset-weighted basis, the average expense ratio incurred by all mutual fund investors in stock mutual funds was 0.88%. And the asset-weighted average expense ratio for 401(k) stock mutual fund investors was even lower: 0.74%. Similar results can be seen in each broad type of stock fund, as well as in bond funds. Overall, the asset-weighted average expense ratio across all mutual funds in 401(k) plans was 0.71% in 2006. These expense ratios include any revenue sharing that a fund pays to defray the cost of 401(k) plan administration.

401(k) Mutual Fund Investors Tend to Pay Lower-Than-Average Expenses

Percent of assets, 1996–2006



[1] *The industry average expense ratio is measured as an asset-weighted average.*

[2] *The 401(k) average expense ratio is measured as a 401(k) asset-weighted average.*

note: Figures exclude mutual funds available as investment choices in variable annuities and tax-exempt mutual funds.

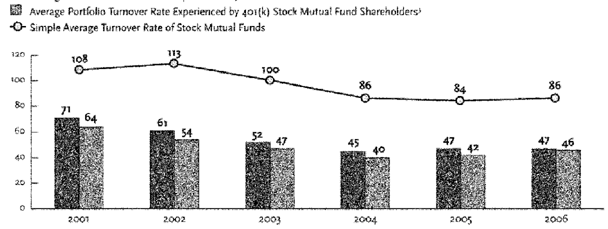
sources: Investment Company Institute; Lipper; Value Line Publishing, Inc.; CDA/Wiesenberger Investment Companies Service; © CRSP University of Chicago, used with permission, all rights reserved (312.263.6400/ www.crsp.com); Primary datasource; and Strategic Insight Simfund

There are several factors that contribute to the relatively low average fund expense ratios incurred by 401(k) plan participants. Plan sponsors play a vital role in selecting and regularly evaluating the plan's investment line-up to ensure that each option's fees and expenses provide good value. Easy access to comparable and transparent mutual fund fee information helps employees in selecting investments for their accounts.[15]

Because the costs of trading a mutual fund's portfolio affect total shareholder return, but are not included in fund expense ratios, the Institute also examined portfolio turnover ratios of mutual funds used in 401(k) plans.[16] Our research found that 401(k) plan participants tend to own stock mutual funds with low turnover rates. The average turnover rate in stock mutual funds held in 401(k) plans was 46% in 2006, which is lower than the simple average turnover rate in stock mutual funds generally (86%) and about the same as the industrywide asset-weighted average rate of 47%.

Average Portfolio Turnover Rate[1] of Stock Mutual Funds

Percent of assets, 2001–2006



[1]The turnover rate for each fund is calculated by dividing the lesser of purchases or sales of portfolio securities for the reporting period by the monthly average of the value of the portfolio securities owned by the fund during the reporting period.

[2]Average portfolio turnover rate experienced by stock mutual fund shareholders is measured as an asset-weighted average annual turnover rate based on the assets held in each fund (reported as a percentage of fund assets).

[3]Average portfolio turnover rate experienced by 401(k) stock mutual fund shareholders is measured as an asset-weighted average annual turnover rate based on 401(k) plan assets held in each fund (reported as a percentage of 401(k) fund assets).

Note: Figures exclude mutual funds available as investment choices in variable annuities. Stock mutual funds include hybrid funds.

Sources: Investment Company Institute and Strategic Insight Simfund

Meeting Plan Fiduciary Needs for Information

Department of Labor section 408(b)(2) project

The Institute believes that we can make certain that plan fiduciaries are equipped to enter into reasonable service arrangements by assuring that they have the information they need to make informed decisions. The Institute supports the Department's initiative to revise its section 408(b)(2) regulations to clarify the information that fiduciaries should obtain in order to enter into and monitor plan service arrangements. We urge the Department to move quickly on this project and to take a commonsense, straightforward approach.

The Department should require plan fiduciaries to obtain information from service providers to the plan on

- What services will be delivered;
- What will be charged for these services and how expenses will be allocated between the sponsor and participants;
- Whether and to what extent the service provider receives compensation from other parties in connection with providing services to the plan.

Disclosure should focus on the cost to the plan of acquiring services, not the cost to the service provider of delivering the service. ERISA does not require plan fiduciaries to assess service provider profitability, but rather to enter into contracts that provide for reasonable compensation.

A service provider that offers a number of services in a package should be required to identify each of the services but not to separately break out the fee for each of the components of the package. If a recordkeeper, for example, provides a comprehensive array of services, including maintaining participant-level accounts, providing custody, and making educational materials and other services available to participants, it should not be forced to assign prices to each component. If the plan sponsor understands the services that will be performed and the total cost of the service arrangement, it will be able to compare overall cost and quality of the bundled provider's offer with an unbundled arrangement available to the plan, and fulfill its responsibility to enter into reasonable service arrangements.

The Department should address revenue sharing disclosure by requiring that a service provider disclose to plan sponsors information about compensation it receives from other parties in connection with providing services to the plan. This information will allow the plan fiduciary to understand the total compensation a service provider receives under the arrangement. It also will bring to light any potential conflicts of interest associated with revenue sharing payments, for example, where a plan consultant receives compensation from a

plan recordkeeper. The service provider that receives revenue sharing payments should be the entity required to disclose these amounts.

When services are provided to a plan by affiliates of the service provider, a plan fiduciary should understand all the services provided by the service provider and its affiliates and the aggregate compensation paid for those services. The service provider should not be required to disclose how payments within its organization might be allocated among affiliates. In economic terms, transactions between affiliates are not market transactions, and therefore the pricing of these transactions is necessarily artificial and should be of no value to plan sponsors. The reason a firm would choose to organize as a fully integrated firm rather than contract with third parties is that the firm believes it is more efficient to do so. The goal of resource allocation within an integrated firm is to allocate resources in a manner that produces the final bundled product as efficiently as possible, not to ensure that costs can be accurately tracked and allocated to the production of any one product component. In this model, any allocation of revenue, costs and profits among affiliates or business lines has nothing to do with the services provided by the respective affiliates to the plan, but instead is designed for budgeting, accounting and other purposes.

Disclosure tool

To assist plan fiduciaries in discussing service arrangements with providers and to help inform the Department's consideration of new 408(b)(2) guidance, the Institute, together with the American Benefits Council, the American Council of Life Insurers, the American Bankers Association, and the Securities Industry and Financial Markets Association, developed a disclosure tool and submitted it to the Department in July 2006. Plan sponsors can use the tool to better understand plan services and fees and appreciate any potential conflicts of interest that might arise, and any additional compensation providers will receive, through revenue sharing. The tool was developed with significant input from the plan sponsor, service provider and consultant communities to reflect best practices used by sponsors, providers and consultants in today's marketplace.

The tool lists service- and fee-related data elements and is intended, essentially, to help plan fiduciaries satisfy their obligations under ERISA sections 404(a) and 408(b)(2) to understand what services will and will not be provided, and the fees for those services. It can be used regardless of the arrangement, whether a particular provider is offering only one service or a package of services. A service provider offering several services for a single fee would show the single fee and make clear what services are included. The tool also can be used when a plan sponsor works with a consultant in engaging providers and selecting investments and when it does not.[17]

The tool takes the approach to revenue sharing disclosure discussed above. It includes a section for plan fiduciaries and service providers to discuss the extent to which a service

provider receives compensation in connection with its services to the plan from other service providers or plan investment products. For payments received from unaffiliated parties, the tool recommends that plan sponsors and service providers discuss:

- Identification of the unaffiliated party
- Estimate or amount of the payment (including the estimation calculation methodology), and
- Information on the source and nature of the payment.

For payments from affiliated parties, service providers would identify the affiliate, state whether the payment received from the affiliate has any impact on the aggregate revenue received by the firm in connection with services to the plan, and provide non-proprietary information about the nature of the payment.

Conclusion

There is no single "reasonable" fee and service arrangement for a 401(k) plan. A plan fiduciary must consider all the services and investment options being provided, the size and characteristics of the plan, and the services and fees available from other providers. Full-service arrangements that use asset-based fees can be an effective way to deliver the services that 401(k) plans need. The key is that fiduciaries have a process to collect information, compare and monitor providers, and consider any potential conflicts the arrangements might present. The Department should act to increase transparency by requiring service providers to describe the services offered, the charges to be paid, and payments from other parties in connection with providing services to the plan. We are pleased to testify to the Council about improving 401(k) disclosure and look forward to working with the Council and the Department to continue strengthening the 401(k) system.

ATTACHMENTS

- *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2006* (September 2007)
- Joint Submission to DOL by ICI, ABC, ACLI, ABA, and SIFMA on Data Elements Related to Defined Contribution Plan Fee Disclosure (July 31, 2006)

[1] ICI members include 8,803 open-end investment companies (mutual funds), 671 closed-end investment companies, 457 exchange-traded funds, and 4 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately $11.140 trillion (representing 98% of all assets of US mutual funds); these funds serve approximately 93.9 million shareholders in more than 53.8 million households.

[2] On November 10, 1981, IRS issued proposed regulations under the new section 401(k) of the Internal Revenue Code added by Congress in 1978 that clarified the most important interpretative issues under the new law, including whether ordinary wages and salary could be deferred into the plan.

[3] Holden, Brady and Hadley, *401(k) Plans: A 25-Year Retrospective*, ICI Perspective, vol. 12, no. 2 (November 2006), available at http://www.ici.org/stats/res/arc-ret/per12-02.pdf.

[4] Brady and Holden, *The U.S. Retirement Market, 2006,* ICI Fundamentals, vol. 16, no. 3 (July 2007), available at http://www.ici.org/stats/res/1fm-v16n3.pdf.

[5] U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin Historical Tables* (March 2007); Cerulli Associates, "Retirement Markets, 2006," *Cerulli Quantitative Update* (2006).

[6] For example, in 2006, participants in their 20s allocated 59.7% of their accounts to pooled equity investments and company stock, and only 18.4% to GICs and other fixed-income investments. Participants in their 60s allocated 35.6% to GICs and other fixed-income investments. See Holden and VanDerhei, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2006*, ICI Perspective, vol. 13, no. 1, and EBRI Issue Brief, Investment Company Institute and Employee Benefit Research Institute, August 2007, available at http://www.ici.org/stats/res/per13-01.pdf. The 2006 EBRI/ICI database contains 53,931 401(k) plans with $1.228 trillion in assets and 20.0 million participants.

[7] See Holden and VanDerhei, *Can 401(k) Accumulations Generate Significant Income for Future Retirees?* and *The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement*, ICI Perspective and EBRI Issue Brief, Investment Company Institute and Employee Benefit Research Institute, November 2002 and July 2005, respectively, available at http://www.ici.org/pdf/per08-03.pdf and http://www.ici.org/pdf/per11-02.pdf, respectively.

[8] See Statement of Investment Company Institute on Disclosure to Plan Sponsors and Participants Before the ERISA Advisory Council Working Group on Disclosure, September 21, 2004, available at http://www.ici.org/statements/tmny/04_dol_krentzman_tmny.html.

[9] Deloitte Consulting, LLP, International Foundation of Employee Benefit Plans and the International Society of Certified Employee Benefit Specialists, *Annual 401(k) Benchmarking Survey 2005/2006 Edition*.

[10] See Advisory Opinion 97-16A (May 23, 1997) (Aetna) and Advisory Opinion 2003-09A (June 25, 2003) (ABM-AMRO).

[11] In its testimony on July 11, the Department made clear that an arrangement where a recordkeeper shares some of its revenue with the plan does not violate ERISA and plans have a number of options to address the allocation of revenue sharing proceeds.

[12] Deloitte Consulting, LLP, International Foundation of Employee Benefit Plans and the International Society of Certified Employee Benefit Specialists, *Annual 401(k) Benchmarking Survey 2005/2006 Edition.*

[13] Brady and Holden, *The U.S. Retirement Market, 2006,* supra note 4.

[14] We are not aware of any similar cost analysis for other products held in 401(k) plans such as insurance company separate accounts, collective trusts, or separately managed accounts.

[15] For other factors that contribute to the relatively low expense ratio incurred by 401(k) plan participants investing in mutual funds, see Holden and Hadley, *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2006*, ICI Fundamentals, vol. 16, no. 4 (September 2007).

[16] The SEC requires a mutual fund to report its turnover rate, which is broadly speaking a measure of how rapidly the fund is trading the securities in its portfolio relative to total fund assets. Funds also report information on brokerage commission costs in the fund's Statement of Additional Information. Although brokerage commissions are not included in the expense ratio, a mutual fund reports its net return, which reflects all fund trading costs.

[17] Using the tool is not the only way a plan fiduciary could meet its obligations under section 408(b)(2). We do not believe the Department should adopt a particular form in connection with the 408(b)(2) regulations that always must be used. A mandated form would not recognize the variety of service arrangements that might exist, would become outdated over time, and could stifle innovation in the marketplace.

[Whereupon, at 11:30 a.m., the committee was adjourned.]